APPENDIX

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Supreme Court of the United States

October Term, ~~1968~~ 1969

No. ~~922~~ 42

HOWARD ROSS and BERNARD ROSS, as Trustees for Lena Rosenbaum,

Petitioners,

—v.—

ROBERT A. BERNHARD, *et al.*,

Respondents.

On writ of certiorari to the United States Court of Appeals for the Second Circuit

Petition for certiorari filed January 29, 1969
Certiorari granted March 24, 1969

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Docket Entries

(Court of Appeals)

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

APPEAL FROM SOUTHERN DISTRICT

CASE NO. 32118

HOWARD ROSS and BERNARD ROSS, as Trustees for Lena Rosenbaum,

Plaintiffs-Appellees,

v.

ROBERT A. BERNHARD, *et al.*,

Defendants-Appellants.

E. C. McLean

TRANSFERRED FROM MR 1734—CAL. #6

65 Civ. 665

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(Robert A. Bernard, et al.)
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N. Y. N. Y. 10005

WALSH & FRISCH
(The Lehman Corp.)
250 Park Ave.
New York, N. Y. 10017

Docket Entries

DATE	FILINGS—PROCEEDINGS
12-18-67	Filed motion for leave to appeal under Rule 1292(b)
12-21-67	Filed order adjourning motion for leave to appeal to 1-3-68; respondents to answer said petition by 1-3-68
1-3-68	Filed memorandum in opposition to motion for leave to appeal
1-11-68	Filed order granting motion for leave to appeal (Lehman Corp., et al.)
2-23-68	Filed record (original papers of District Court)
3-25-68	Filed order extending time to file appellants brief & appendix to 4-16-68
4-16-68	Filed brief & appendix, appellants
5-6-68	Filed brief, appellees
5-21-68	Filed reply brief, appellants
9-5-68	Argument heard (by: Lumbard, Chj., Smith & Anderson, CJJ)
11-1-68	Judgment Reversed and Action Remanded, Lumbard, Ch J (mailed notices) (4)
11-1-68	Dissenting in separate opinion, Smith, CJ

Docket Entries

DATE	FILINGS—PROCEEDINGS
11-1-68	Filed judgment
11-22-68	Filed itemized and verified bill of costs with proof of service
11-26-68	Filed statement of costs
11-26-68	Issued Mandate (opinion, judgment & statement of costs)
1-24-69	Certified proceedings and original record for Rosenthal & Gurkin
1-28-69	Filed receipt by Supreme Court of certified record
2-4-69	Filed notice of filing of petition for writ of certiorari
3-28-69	Filed certified copy of order of Supreme Court granting petition for writ of certiorari

A4

Docket Entries

(District Court)

CIVIL DOCKET 65 CIV 665

UNITED STATES DISTRICT COURT

Jury demand date: 3-4-65 by pltff.

HOWARD ROSS and BERNARD ROSS, as Trustee for LENA ROSENBAUM,

vs

ROBERT A. BERNHARD	ERNEST R. BREECH
HOWARD L. CLARK	LUCIUS D. CLAY
PAUL L. DAVIES	FREDERICK L. EHRMAN
CLARENCE FRANCIS	MONROE C. GUTMAN
JAMES K. HART	JAMES M. HESTER
DONALD P. KIRCHER	ROBERT LEHMAN
PAUL E. MANHEIM	PAUL M. MAZUR
THOMAS A. MORGAN	ALVIN W. PEARSON
T. S. PETERSEN	B. EARL PUCKETT
JOHN W. REAVIS	CHARLES B. THORNTON
FRAZAR B. WILDE; and	
ROBERT LEHMAN	MONROE C. GUTMAN
PAUL M. MAZUR	JOSEPH A. THOMAS
FREDERICK L. EHRMAN	H. J. SZOLD
PAUL E. MANHEIM	HERMAN M. KAHN
MORRIS NATELSON	EDWIN L. KENNEDY
FRANK J. MANHEIM	ALLAN B. HUNTER
MARCEL A. PALMARO	WILLIAM H. OSBORNE, JR.
ARTHUR D. SCHULTE	ROBERT A. BERNHARD

ALVIN W. PEARSON, individually and as partners doing business under the firm name and style of LEHMAN BROTHERS; and THE LEHMAN CORPORATION

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For defendant:

SULLIVAN & CROMWELL (*Howard L. Clark*)
48 Wall St., NYC

WALSH & FRISCH (*Lehman Corp.*)
250 Park Ave. NY NY

SIMPSON THACHER & BARTLETT
(*defts. Robert A. Bernhard, et al.*)
120 Broadway, NYC

Docket Entries

DATE	PROCEEDINGS
(B)	
Mar. 4-65	Filed complaint and issued summons.
Mar. 25-65	Filed stip. & order extending time for deft. Lehman Corp. to answer to 5-3-65—Cannella, J.
Mar. 25-65	Filed stip. & order extending time for deft. Howard L. Clark to answer to 5-3-65—Cannella, J.
Mar. 31-65	Filed stip. & order extending time of defts. Robert A. Bernhard, et al. to answer to 5-3-65—Herlands, J.
Apr. 13-65	Filed summons & return, served Lehman Corp. 3-11-65; Lehman Bros. 3-11-65; Robert Lehman 3-16-65; Paul Mazur 3-16-65; & Howard L. Clark 3-10-65
Apr. 29-65	Filed stip. & order extending time for deft. Howard L. Clark to answer to 6-2-65—Cashin, J.
May 4-65	Filed stip. & order extending time of defts. Robert A. Bernhard, et al. to answer to 6-2-65—Feinberg, J.
May 4-65	Filed stip. & order extending time of deft. Lehman Corp. to answer to 6-2-65—Feinberg, J.

Docket Entries

DATE	PROCEEDINGS
June 3-65	Filed stip. & order extending time for deft. Lehman Corp. to answer to 7-8-65—McGohey, J.
June 3-65	Filed stip. & order extending time for deft. Howard L. Clark to answer to 7-8-65—McGohey, J.
June 7-65	Filed stip. & order extending time for defts. Robert A. Bernhard, et al. to answer to 7-8-65—Palmieri, J.
July 8-65	Filed Answer to deft. Howard L. Clark
July 13-65	Filed Answer of deft. The Lehman Corp.
July 15-65	Filed stip. & order extending time of deft. Lehman Brothers to answer etc. tp 7-15-65—Bonsal, J.
July 20-65	Filed Answer of defts. Robert A. Bernhard, Lucius D. Clay, Frederick L. Ehrman, Monroe C. Gutman, Robert Lehman, Paul E. Manheim, Paul M. Mazur, Alvin W. Pearson, Joseph A. Thomas, H. J. Szold, Herman H. Kahn, Morris Natelson, Edwin L. Kennedy, Frank J. Manheim, Allan B. Hunter, Marcel A. Palmaro, William H. Osborne, Jr. & Arthur D. Schulte individually and as partners doing business as Lehman Bros.

Docket Entries

DATE	PROCEEDINGS
Apr. 5-66	Filed deft's interrogs.
Apr. 14-66	Filed pltff's notice to take deposition.
Apr. 13-66	Issued additional summons.
Apr. 18-66	Filed deft Lehman's ans. to interrogs.
Apr. 15-66	Filed stip. & order extending deft. Lehman's time to ans. etc. to interrogs. to 5-2-66—Murphy, J.
Apr. 28-66	Filed summons & return—served F. Wilde on 4-21-66 in Dist. of Conn.
May 3-66	Filed stip. & order adjourning deposition of R. Lehman to 5-18-66 & right to object to that deposition is reserved—McLean, J.
May 9-66	Filed defts interrogs.
May 10-66	Filed Answer of deft. F. Wilde.
May 23-66	Filed stip. & order that deposition of deft. Robert Lehman be amended by substituting the name of deft. Alvin W. Pearson and said deposition be adjourned to 6-17-66—Wyatt, J.
June 2-66	Filed pltff's ans. to interrogs.
June 20-66	Filed order—pltff has 90 days to file note of issue etc.—McGohey, J.

Docket Entries

DATE	PROCEEDINGS
June 20-26	Call for review—G.R. 2 days before—McGohey, J.—90 D/C
June 23-66	Filed stip. & order adjourning deposition of Alvin Pearson to 7-15-66—Tenney, J.
Aug. 2-66	Filed stip. & order adjourning deposition of A. Pearson to 8-5-66—Herlands, J.
Sept. 12-66	Filed pltff's affdvt. & notice of motion—Discovery & inspection—Ret. 9-20-66
Sept. 20-66	Filed affdvt., consent & order extending ptlff's time to file note of issue to 3-19-67—Sugarman, J.
Sept. 21-66	Filed memo endorsed on motion filed 9-12-66—Motion consented to. Settle order Bryan, J.
Oct. 6-66	Filed pltff's affdvt. & order—that pltff's motion for discovery inspection is granted etc. as indicated—Bryan, J. mailed notice
(C)	
Oct. 27-66	Filed pltff's copy of order with notice of entry
Nov. 4-66	Filed pltff's notice of taking deposition.
Nov. 15-66	Filed deft. (Lehman et al.) interrogs.
Dec. 30-66	Filed pltff's interrogs.

Docket Entries

DATE	PROCEEDINGS
Jan. 18-67	Filed stip & order extending time of defts to object etc. (re: interrogs. to 1-17-67 that defts answer interrogs. extended to 1-23-67—Edelstein, J.
Jan. 19-67	Filed deft's R. A. Bernhard et al notice of motion—objections to pltff's interrogs.—Ret 1-26-67
Jan. 19-67	Filed deft's (R. A. Bernhard et al) memorandum in support of their motion.
Jan. 24-67	Filed deft (Clark & Wilde) answers to written interrogs.
Jan. 25-67	Filed stipulation—adjourning objections of deft. to 2-2-67
Jan. 27-67	Filed pltff's affdvt in opposition to deft's objections to pltff's interrog.
Jan. 27-67	Filed memorandum in opposition to defts' objections to pltff's interrogs.
Feb. 23-67	Filed pltff's answers to defts' interrogs.
Feb. 27-67	Issued 6 additional summons
Feb. 27-67	Filed consent & order—Motion for substitution—of Howard Ross & Bernard Ross (the "Petitioners") substituting them as Trustees for Lena Rosenbaum as pltff's in place of

Docket Entries

DATE	PROCEEDINGS
	Frank Ross—former trustee—So ordered—Motley, J.
Feb. 28-67	Filed pltff's interrogs
Feb. 28-67	Filed pltff's notice of taking deposition
Mar. 1-67	Filed pltff's notice of taking deposition of Alvin W. Pearson
Mar. 1-67	Filed pltff's notice of taking deposition of Howard L. Clark
Mar. 1-67	Filed deposition of Frazar B. Wilde. Mailed notice.
Feb. 2-67	Filed affdvt. of deft. Lawrence M. McKenna (filed in Court)
Mar. 2-67	Filed pltff's memorandum in response to deft's reply memorandum
Mar. 2-67	Filed deft's reply memorandum
Mar. 2-67	Filed memorandum endorsed on motion filed on 1-19-67—We find no showing that answers to these interrogs. will be burdensome—and no reason appears why answers should be delayed until defts' interrogs have been answered—Objections are overruled—So ordered—Ryan, J. Mailed notice.

Docket Entries

DATE	PROCEEDINGS
Mar. 9-67	Filed pltff's affdvt. & notice of motion—File supplemental complaint—Ret. 3-21-67
Mar. 21-67	Filed additional summons & ret—Served John W. Reavis personally on 3-3-67 at Cleveland ND of Ohio
Mar. 21-67	Filed pltff's affdvt. & notice of motion extend time to file N/I—Ret. 3-17-67
Mar. 21-67	Filed memo endorsed on motion filed this date—Sufficient reason therefor approving this application it granted—So ordered—Sugarman, J. m/n
Mar. 22-67	Filed memo endorsed on motion filed 3-9-67—Motion consented to—Settle order—Bryan, J.
Mar. 29-67	Filed order & notice of settlement—that pltff's motion is granted and that pltff. be granted leave to file a supplemental complaint—Bryan, J. m/n
Apr. 7-67	Filed copy of order with notice of entry.
May 9-67	Filed stipulation between parties—that pltffs' supplemental complaint is deemed to have been served as of the date of this stipulation etc.
May 11-67	Filed stip. & order extending time of defts. Bernhard, et al. to answer interrogs. to 5-12-

DATE	PROCEEDINGS
	67—deposition of Alvin W. Pearson is adjourned to 5-19-67—Wyatt, J.
May 17-67	Filed defts' (Bernard, et al.) answers to interrogs.
May 26-67	Filed pltff's affdvt. & notice of motion to amend complaint—ret. 6-6-67
June 2-67	Filed stip. & order—in lieu of answering pltff's 1st amended complaint—deft. P. L. Davies will answer pltff's supplemental complaint—time of defts Bernhard, et al. to answer pltff's supplemental complaint be extended from 3-29-67 to and including the tenth day after entry of an order disposing of pltffs' pending motion for leave to file 2nd amended complaint—So ordered—Tyler, J.
June 5-67	Filed stipulation between parties adjourning pltffs' motion for leave to serve amended complaint to 6-13-67
(D)	
June 16-67	Filed pltff's affdt. & notice of motion—produce & inspect (deft. Lehman) Ret. 6-22-67
June 16-67	Filed pltff's affdvt. & notice of motion—produce & inspect (various defts) Ret. 6-22-67
June 19-67	Filed affdt. of Cornelius B. Prior, Jr. in opposition to pltff's motion

Docket Entries

DATE	PROCEEDINGS
June 19-67	Filed memorandum in opposition to pltff's motion
June 21-67	Filed affdvt. of Theodore J. Kircher in opposition to pltffs' motion
June 21-67	Filed deft's (Bernard, et al.) memorandum in opposition
June 21-67	Filed affdvt. of E. Roger Frisch in opposition
June 21-67	Filed affdvt., stip. & order extending pltffs' time to file note of issue to 6-26-67—Sugarman, J.
June 22-67	Filed affdvt. of Lawrence M. McKenna in opposition
June 22-67	Filed memo endorsed on motion to amend complaint—filed 5-26-67—Motion granted. Settle order as agreed upon by counsel following argument—Bonsal, J.
June 23-67	Filed pltff's requests for admissions.
June 26-67	Filed pltff's memorandum in support of discovery
June 27-67	Filed stip. & order extending time to file note of issue to 6-30-67—Sugarman, Ch.J.
June 30-67	Filed pltff's Note of Issue & Statement of readiness.

Docket Entries

DATE	PROCEEDINGS
June 30-67	Filed memo endorsed—motion for discovery withdrawn—So ordered—Bryan, J.
June 29-67	Filed in court pltff's 9F affdvt.
June 30-67	Filed memo endorsed—motion to produce denied—following argument—So Ordered—Bryan, J. M/N
July 6-67	Filed consent & order—that pltff's are granted leave to file and serve a 2nd amended complaint—defts are excused from answering any previous complaint—that the right of defts to interpose any defense to aforesaid 2nd amended complaint including without limitation—defense of the statute of limitations be and is reserved to them—that the right of defts to assert that any claim asserted in 2nd amended complaint did not arise out of any conduct—transaction or occurrence set forth etc. in the original—that amendment permitted by this order does not relate back to date of the original etc.—that defts may conduct discovery proceedings with respect to newly interposed claims—concerning interpositioning etc. contained in proposed 2nd amended complaint during 90 days succeeding date of this order irrespective of filing by plff. of note of issue on or before 6-30-67—Bonsal, J.

Docket Entries

DATE	PROCEEDINGS
July 13-67	Filed 2nd amended complaint
Aug. 8-67	Filed stip. & order extending time for defts to move or answer to amended complaint to 8-10-67—Motley, J.
Aug. 8-67	Filed stip. & order extending time of defts to answer second amended complaint to 8-10-67 —Motley, J.
Aug. 9-67	Filed defts' Clark, Francis, Kircher, Puckett, Reavis, Thornton & Wilde affdvt. & notice of motion to strike jury demand ret. 8-15-67
Aug. 9-67	Filed defts' memorandum in support of its motion
Aug. 10-67	Filed answer of defts (Howard L. Clark et al.) to amended complaint
Aug. 14-67	Filed answer of defts Bernhard et al. to to amended complaint
Aug. 14-67	Filed answer of defts Bernhard et al. to amended complaint
Aug. 14-67	Filed stipulation between parties—for order to strike pltffs' demand for Jury trial & transfer case to non-jury cal—adjourned from 8-15-67 to 8-29-67

Docket Entries

DATE	PROCEEDINGS
Sept. 5-67	Filed additional summons—Served Charles B. Thornton—by him—Central Dist. of Cal. 3-6-67
Sept. 5-67	Filed add. summons & ret—unexecuted—on Ernest Breech.—8-10-67
Sept. 5-67	Filed add. summons & ret—Rosenthal & Gurkin—Served P. L. Davies 4-26-67—ND of Cal.
Sept. 5-67	Filed add. summons & ret—Served C. Francis—by Mrs. B. F. Wright—Daughter—3-2-67—D. P. Kircher—personally on 3-1-67—unable to find T. A. Morgan.—served B. E. Puckett—personally on 3-2-67
Sept. 11-67	Filed Amended Answer of deft. (Lehman Corp.)
Sept. 10-67	Filed deft (Behrnard et al.) interrogs.
(E)	
Aug. 28-67	Filed pltff's memorandum in opposition to defts' motion to defts' motion to strike pltffs' demand for jury trial
Nov. 6-67	Filed memo endorsed on motion filed 8-9-67—deft's motion to strike Jury Demand is denied—So ordered—McLean, J. mailed notice.
Nov. 20-67	Filed deft's (Clark Francis) notice of motion (with affdvt.—amend & resettle order Ret. 11-28-67)

Docket Entries

DATE	PROCEEDINGS
Nov. 20-67	Filed deft's memorandum in support of motion to amend etc.
Nov. 21-67	Filed pltff's memorandum in opposition to deft's motion to amend & resettle order
Nov. 22-67	Filed order pursuant to rules 6 & 13—Sugarman, J.
Nov. 28-67	Filed Designation of Trial Counsel for Plaintiffs.
Nov. 29-67	Filed Reply Memorandum in support of defts' motion to amend.
Nov. 29-67	Filed Memo. End. on motion papers filed 11/20/67. Motion granted. Settle order on notice. McLean, J. (mailed notice)
Nov. 29-67	Filed deft's (Bernhard et al.) notice of designation of trial counsel
Nov. 30-67	Filed pltffs' answers to defts' interrogs of 10-5-67
Nov. 30-67	Filed deft's (Clark et al.) notice of designation of trial counsel
Dec. 1-67	Filed deft (Lehman Corp.) notice of designation of trial counsel

Docket Entries

DATE	PROCEEDINGS
Dec. 1-67	Filed stip. & order—extending time of pltffs' to answer interrogs of 10-5-67 to 12-5-67—Mansfield, J.
Dec. 6-67	Filed defts (Clark Francis et al.) notice of appeal—Mailed copies 12-6-67 to Rosenthal & Gurkin and Pomerantz, Levy Haudek & Block.
Dec. 7-67	Filed order—that motion of defts is granted and that memorandum & order file 11-6-67 be amended etc. as indicated—McLean, J. mailed notice
Jan. 12-68	Filed affidavit of Richard M. Meyer
Jan. 12-68	Filed deft's affdvt & notice of motion for 9L application etc. ret. 1-4-68
Jan. 12-68	Filed memo endorsed on motion filed 1-12-68—9L application denied—settle order on notice—Bonsal, J.
Jan. 15-68	Filed Notice of Appeal (mailed copy)
Jan. 12-68	Pre-Trial—Bonsal, J.
Feb. 23-68	Filed Defts. (Clark) Stipulation

Second Amended Complaint

(40)

UNITED STATES DISTRICT COURT

FOR THE SOUTHERN DISTRICT OF NEW YORK

65 Civ. 665

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,

Plaintiffs,

—against—

ROBERT A. BERNHARD, ERNEST R. BREECH, HOWARD L. CLARK, LUCIUS D. CLAY, PAUL L. DAVIES, FREDERICK L. EHRMAN, CLARENCE FRANCIS, MONROE C. GUTMAN, JAMES K. HART, JAMES M. HESTER, DONALD P. KIRCHER, ROBERT LEHMAN, PAUL E. MANHEIM, PAUL M. MAZUR, THOMAS A. MORGAN, ALVIN W. PEARSON, T. S. PETERSEN, B. EARL PUCKETT, JOHN W. REAVIS, CHARLES B. THORNTON, FRAZAR B. WILDE: and MONROE C. GUTMAN, ROBERT LEHMAN, JOSEPH A. THOMAS, PAUL M. MAZUR, H. J. SZOLD, FREDERICK L. EHRMAN, HERMAN M. KAHN, PAUL E. MANHEIM, EDWIN L. KENNEDY, MORRIS NATELSON, ALLAN B. HUNTER, FRANK J. MANHEIM, WILLIAM H. OSBORNE, JR., MARCEL A. PALMARO, ROBERT A. BERNHARD, ARTHUR D. SCHULTE, ALVIN W. PEARSON, individually and as partners doing business under the firm name and style of LEHMAN BROTHERS and THE LEHMAN CORPORATION,

Defendants.

Second Amended Complaint

PLAINTIFFS DEMAND TRIAL BY JURY

Plaintiffs by their attorneys, Rosenthal & Gurkin, for their complaint, allege on information and belief, except as to paragraph 2, which is alleged on knowledge:

1. The jurisdiction of the Court is based on the Investment Company Act of 1940, 15 U.S.C. Secs. 80 a-1, et seq. and on the principles of pendent jurisdiction.

2.(a) Plaintiffs are shareholders of defendant, The Lehman Corporation (the "Corporation"), and they and their predecessor in interest have been shareholders since 1961, and at the times of the wrongs complained of herein.
(41)

(b) Plaintiffs bring this action derivatively on behalf of the Corporation and representatively on behalf of themselves and all other shareholders of the Corporation similarly situated.

(c) This action is not brought collusively to confer on the Court jurisdiction which it otherwise would not have.

3.(a) The Corporation is organized under the laws of Delaware, and has its principal office at One South William Street, in the City, County and State of New York.

.(b) The Corporation has been at all times relevant hereto, and now is a diversified closed-end management investment company, and it is registered as such under the Investment Company Act of 1940 (the "Act"), 15 U.S.C. Sections 80 a-1 et seq.

4.(a) Defendants, Bernhard, Breech, Clark, Clay, Davies, Ehrman, Francis, Gutman, Hart, Hester, Kircher, Lehman, Manheim, Mazur, Morgan, Pearson, Petersen, Puckett, Reavis, Thornton and Wilde are or have been the Corporation's directors.

(b) In addition, defendant Lehman is chairman of the Corporation's board of directors; defendant Gutman is vice-chairman; defendant Pearson is president; defendant Hart is executive vice-president; and defendant Manheim is or has been vice-president.

5. Defendants Lehman, Gutman, Mazur, Thomas, Ehrman, Szold, Manheim, Kahn, Natelson, Kennedy, Manheim, Hunter, Palmaro, Osborn [sic], Schulte, Bernhard and Pearson are partners in Lehman Brothers.

6. Lehman Brothers is an investment banking firm, and is a member of the New York Stock Exchange and other (42) exchanges. Its principal office is at One William Street, in the City, County and State of New York.

7. Lehman Brothers is able to and does dominate and control the Corporation and its personnel, its policies and its board of directors. Lehman Brothers' partners occupy the key executive posts of the Corporation, including board chairman, vice-chairman, president and vice-president.

8. The Corporation, a registered investment company, invests and reinvests its assets in the securities of other companies, most of which are traded on the New York Stock Exchange.

9.(a) Lehman Brothers acts as the Corporation's broker for most of the Corporation's portfolio transactions, and receives therefor the standard stock exchange commissions.

(b) In 1964, the Corporation incurred brokerage commissions of $531,724. Of this amount, $442,903 was paid to Lehman Brothers (of which $48,480 was paid to other brokers). Similar amounts were incurred and paid in prior years. Over the past five years, Lehman Brothers has received approximately $2,000,000 (two million) in brokerage commissions from the Corporation.

(c) In 1965, the Corporation incurred brokerage commissions of $538,622. Of this amount $334,685 was paid to Lehman Brothers (of which $41,688 was paid to other brokers).

(d) In 1966, the Corporation incurred brokerage commissions of $405,772. Of this amount $351,640 was paid to Lehman Brothers (of which $43,085 was paid to other brokers). These expenses and payments are continuing at the present time.

(43)

10. The Corporation's brokerage commission payments to Lehman Brothers have been and are for the mechanical execution of the Corporation's portfolio transactions; Lehman Brothers makes a separate charge for any other services it renders.

11. Lehman Brothers has made and continues to make a substantial profit from the brokerage commissions it receives from the Corporation.

12. This brokerage profit that Lehman Brothers realizes at the Corporation's expense is not an expense that the Corporation need—or should—incur. Most of the Corporation's portfolio transactions for which Lehman Brothers has received and continues to receive substantial commissions are transactions that are carried out on the New York Stock Exchange or other national securities exchanges. However, these same transactions could be executed otherwise than on a national securities exchange, in the so-called "Third Market", at favorable net prices without the payment of any commissions, or they could be conducted otherwise than on a national securities exchange at favorable prices with the payment of substantially smaller commissions than those paid by the Corporation.

13. The Corporation purchases and sells a substantial amount of securities which are not listed on a national securities exchange and are traded exclusively in the over-the-counter market. The Corporation makes most of its purchases and sales of such securities through Lehman Brothers, for which it has paid and continues to pay Lehman Brothers substantial brokerage commissions at rates equal to those prevailing on the New York Stock Exchange.

(44)

14. In so executing transactions, the Corporation has failed to obtain the most favorable prices and executions for the purchase and sale of portfolio securities. Instead, the Corporation has interposed Lehman Brothers between the Corporation and those brokers and dealers and others from whom the most favorable prices and executions are available.

15. The brokerage commissions received by Lehman Brothers for the execution of over-the-counter transactions are gratuitous payments to Lehman Brothers for which no service of value is rendered. They consist of commissions for transactions executed in the over-the-counter market with "market makers" (i.e., dealers who advertise their willingness to buy and sell particular securities) and others, all of whom would have dealt directly with the Corporation on the same basis as they dealt with Lehman Brothers. By dealing directly with such persons, the Corporation could have saved the commissions paid to Lehman Brothers.

16. The opportunity to control the brokerage business generated by the Corporation's own portfolio transactions which should belong to the Corporation has been diverted by Lehman Brothers. As a result of this diversion, the Corporation has suffered at least these damages: The Corporation has not been able to conduct its own brokerage business; and it has not been able to obtain the lowest brokerage commissions that are available.

17. The reason the Corporation makes virtually all of its purchases and sales through the facilities of Lehman Brothers and the stock exchanges is that Lehman Brothers, which dominates and controls the Corporation, prefers to profit at the Corporation's expense and to its detriment.

(45)

18. (a) Approximately 15% of the brokerage commissions paid by the Corporation has been and continues to be

allocated to brokers who provide investment advice to Lehman Brothers. The practice of thus allocating an investment company's brokerage commissions is known in the investment company industry as "reciprocal brokerage".

(b) Lehman Brothers is limited in its compensation as investment adviser of the Corporation to the amount provided in its investment advisory contract with the Corporation. By the use of reciprocal brokerage, Lehman Brothers receives compensation in excess of the amount specified therein.

(c) If it were not for the use of reciprocal brokerage, Lehman Brothers would be forced to pay out of its own pocket for the investment advice it receives from other brokers.

(d) Reciprocal brokerage provides excessive compensation for Lehman Brothers in violation of the investment advisory contract and the Act.

(e) The utilization of reciprocal brokerage to benefit Lehman Brothers has deprived the Corporation of the opportunity to deal in the third market and to realize savings thereby.

19. The Act (Sec. 10(b) (1)) requires that the Corporation's board of directors be composed of persons a majority of whom are unaffiliated with Lehman Brothers, the Corporation's broker. But at all times relevant hereto at least 50% of the Corporation's directors were and they are affiliated with Lehman Brothers by reason of their being partners in Lehman Brothers, or by reason of their being (46) directly or indirectly conrtolled by, or under common con-

trol with Lehman Brothers in violation of Sections 10(b) (1), 2(a) (3) and 2(a) (9) of the Act.

20. By reason of these violations of the Act, the brokerage commissions paid by the Corporation to Lehman Brothers have been and are illegal.

21. The payment of these brokerage commissions to Lehman Brothers and others has constituted and continues to constitute an unlawful and willful conversion by Lehman Brothers and the individual defendants of the monies, funds, property and assets of the Corporation to the use of Lehman Brothers in violation of Sec. 37 of the Act; and gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence and a reckless disregard of their fiduciary duties by the Corporation's officers, directors and brokers in violation of the duties which the Act (Secs. 1(b) (2), 10, 17 (h) and (i) and 36) expressly and by necessary implication imposes upon officers, directors and brokers of investment companies.

22. The payment of these excessive brokerage commissions by the Corporation to Lehman Brothers and others constituted and constitutes a breach by the individual defendants and Lehman Brothers of the fiduciary duties they owe to the Corporation; and the payments of the brokerage commissions amount to a waste and spoliation of the Corportion's assets for the benefit and profit of Lehman Brothers and the individual defendants, but to the harm and detriment of the Corporation.

23. Demand on the Corporation's board of directors to bring this action would be futile because;

(47) (a) The defendant directors are the principal wrong-doers, some of whom have personally profited from the illegal and improper acts alleged herein;

(b) A majority of the Corporation's directors participated in the alleged wrongs; and

(c) The institution of this action by the directors would place it in hostile hands and would prevent its effective prosecution.

20. The Corporation has about 35,000 shareholders. They are so numerous as to make it impracticable to bring them all before the Court. Plaintiff will fairly insure their adequate representation.

WHEREFORE, plaintiff prays for judgment:

A. Requiring the defendants jointly and severally to account for and pay to the Corporation for their profits and gains and its losses;

B. Awarding the plaintiff the costs and expense of this action, including reasonable counsel fees; and

C. Granting plaintiff such other and further relief as may be just.

ROSENTHAL & GURKIN
Attorneys for Plaintiff
19 West 44th Street
New York, N. Y.

(Verified by Alfred Gurkin on June 23, 1967).

Notice of Motion on Behalf of Defendants

(50)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

[SAME TITLE]

SIRS:

PLEASE TAKE NOTICE that upon the annexed affidavit of Cornelius B. Prior, Jr., sworn to July 28, 1967, the second amended complaint filed on July 14, 1967 and upon all the pleadings and papers filed herein, defendants will move this Court at a motion part thereof, at the United States Courthouse, Room 506, Foley Square, New York, New York, on August 15, 1967, at 10 o'clock in the forenoon of that day or as soon thereafter as counsel can be heard, for an order pursuant to Rule 39(a) (2) of the Federal Rules of Civil Procedure striking plaintiffs' demand for jury trial and transferring this case to the Non-Jury Calendar on the grounds that plaintiffs have no right to a jury under the Constitution or statutes of the United States.

Dated: New York, New York
August 4, 1967

Yours, etc.,

SULLIVAN & CROMWELL
By JOHN DICKEY
(A Member of the Firm)
Attorneys for Defendants
Clark, Francis, Kircher,
Puckett, Reavis, Thornton
and Wilde
48 Wall Street,
New York, New York 10005

Notice of Motion on Behalf of Defendants

(51)

SIMPSON THACHER & BARTLETT

By ROY L. REARDEN
(A Member of the Firm)
Attorneys for Defendants
Robert A. Bernhard, et al.,
120 Broadway
New York, New York 10005

WALSH & FRISCH

By E. ROGER FRISCH
(A Member of the Firm)
Attorneys for Defendant
The Lehman Corporation,
250 Park Avenue,
New York, New York 10017

To:

ROSENTHAL & GURKIN,
Attorneys for Plaintiffs,
19 West 44th Street,
New York, New York 10017.

POMERANTZ LEVY HAUDEK & BLOCK,
Attorneys for Plaintiffs,
295 Madison Avenue,
New York, New York 10017.

Affidavit of Cornelius B. Prior, Jr. in Support of Foregoing Motion

(52)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

[SAME TITLE]

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

CORNELIUS B. PRIOR, JR., being duly sworn, deboses and says:

1. I am associated with Sullivan & Cromwell, counsel for defendants, Clark, Francis, Kircher, Puckett, Reavis, Thornton and Wilde. I am familiar with the facts and proceedings in this action and make this affidavit in support of the instant motion by all defendants to strike plaintiffs' demand for jury trial.

2. The original complaint in this action was filed on March 4, 1965, alleging that the individual defendants, directors of The Lehman Corporation ("Corporation"), had breached their fiduciary duties to the Corporation by effecting security transactions for the Corporation's investment portfolio on registered securtity exchanges rather than off the exchanges in what plaintiffs call a "third-market", where commissions are allegedly lower. A jury trial was demanded.

Affidavit of Cornelius B. Prior, Jr. in Support of Foregoing Motion

3. On February 7, 1967, the complaint was amended, with the consent of defendants, in order to substitute as plaintiffs the present trustees for Lena Rosenbaum following (53) the death of the prior trustee. On March 21, 1967, an order was entered granting plaintiffs leave to file a supplemental complaint which renewed the original claims with respect to the period subsequent to the filing of the original complaint.

4. On May 25, 1967, plaintiffs moved for an order granting them leave to file a second amended complaint setting forth additional claims based on alleged "interpositioning" and "reciprocal business". Plaintiffs' motion was granted by this Court following a hearing before Judge Bonsal on June 21, reserving to defendants the right to discovery with respect to the new claims and the right to show at trial that the new claims do not relate back to the date of the original complaint.

5. Plaintiffs' note of issue was filed on June 30, 1967. The second amended complaint was filed on July 13 (a copy is annexed hereto as Exhibit A), again with an endorsed demand for jury trial. On July 21 defendants were notified by the Calendar Clerk that the case had been assigned to Jury Calendar Number 2 (Calendar No. 177).

(Sworn to by Cornelius B. Prior, Jr. on July 28, 1967).

Answer of Defendants Howard L. Clark, et al., to Second Amended Complaint

UNITED STATES DISTRICT COURT

FOR THE SOUTHERN DISTRICT OF NEW YORK

[SAME TITLE]

Defendants Howard L. Clark, Clarence Francis, Donald P. Kircher, John W. Reavis, Charles B. Thornton, B. Earl Puckett and Frazar B. Wilde, by their attorneys, Sullivan & Cromwell, answering the second amended complaint herein:

1. Deny each and every allegation of paragraph 1.

2. Deny knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 2, except deny that this action is brought for the benefit of defendant The Lehman Corporation ("Corporation").

3. Deny each and every allegation of paragraph 6, except admit that Lehman Brothers is an investment banking firm, is a member firm of the New York Stock Exchange and other exchanges, and has its principal office at One William Street in the City, County and State of New York.

4. Deny each and every allegation of paragraph 7, except admit that partners of Lehman Brothers occupy the positions of Chairman of the Board, Vice Chairman of the Board, President and Executive Vice President of the Corporation.

5. Deny each and every allegation of paragraph 8, except admit: The Corporation is registered under the Investment Company Act of 1940. The Corporation's assets are invested almost entirely in securities of other corporations and, for the most part, the securities held by the Corporation are listed on the New York Stock Exchange.

6. Deny each and every allegation of paragraph 9, except admit that a substantial part of the Corporation's portfolio transactions are executed by Lehman Brothers, always at commission rates which do not exceed the minimum rates prescribed by the stock exchange upon which the transaction is executed. During the past five years Lehman Brothers has received commissions from the Corporation. The amounts paid from 1964 through 1966 are as follows:

	1964	1965	1966
Total brokerage commissions paid by Corporation	$531,724	$538,622	$405,772
Commissions paid to Lehman Brothers	442,903	334,685	351,640
Payments by Lehman Brothers to other brokers out of commissions paid by Corporation	48,480	41,688	43,085

7. Deny each and every allegation of paragraph 10.

8. Deny each and every allegation of paragraph 11, except admit, on information and belief that Lehman Brothers earns profits on the brokerage commissions received by it from the Corporation.

9. Deny each and every allegation of paragraph 12.

10. Deny each and every allegation of paragraph 13, except admit that the Corporation purchases and sells securities which are not listed on a national securities exchange from time to time and that some of these transactions are effected for the Corporation by Lehman Brothers.

11. Deny each and every allegation in paragraphs 14, 15, 16, 17 and 18.

12. Deny each and every allegation of paragraph 19 and begs leave to refer for the terms thereof to the Investment Company Act of 1940.

13. Deny each and every allegation of paragraphs 20, 21, 22, and 23.

14. Deny each and every allegation of paragraph 24 (erroneously numbered "20" in the second amended complaint), except admit that the Corporation has approximately 35,000 shareholders.

FIRST AFFIRMATIVE DEFENSE

15. Plaintiffs have failed without legal excuse or justification to make demand upon the Board of Directors of the Corporation that the claim or claims alleged in the second amended complaint be asserted by the Corporation.

SECOND AFFIRMATIVE DEFENSE

16. Plaintiffs have failed without legal excuse or justification to make demand upon the stockholders of the

Corporation that the claim or claims alleged in the second amended complaint be asserted by the Corporation.

THIRD AFFIRMATIVE DEFENSE

17. The cause or causes of action alleged in the second amended complaint did not accrue within six years next prior to the commencement of the action.

FOURTH AFFIRMATIVE DEFENSE

18. The cause or causes of action alleged in the second amended complaint did not accrue within three years next prior to the commencement of the action.

FIFTH AFFIRMATIVE DEFENSE

19. Plaintiffs have been guilty of inordinate delay in commencing this action and, accordingly, this action is barred by laches.

SIXTH AFFIRMATIVE DEFENSE

20. Plaintiffs have approved and ratified the acts alleged as a cause or causes of action in the second amended complaint and are thereby estopped from maintaining this action.

SEVENTH AFFIRMATIVE DEFENSE

21. The claims alleged concerning "reciprocal brokerage" and "interpositioning" in paragraphs 13 through 15

and 18 and related paragraphs of the second amended complaint did not accrue within three years next prior to assertion of said claims by service of the second amended complaint and do not relate back to the date of the commencement of this action.

22. The claims alleged concerning "reciprocal brokerage" and "interpositioning" in paragraphs 13 through 15 and 18 and related paragraphs of the second amended complaint did not accrue within six years next prior to assertion of said claims by service of the second amended complaint and do not relate back to the date of the commencement of this action.

WHEREFORE, defendants Clark, Francis, Kircher, Puckett, Reavis, Thornton and Wilde demand judgment dismissing the second amended complaint, together with the costs and disbursements of this action.

SULLIVAN & CROMWELL

By MARVIN SCHWARTZ
(A Member of the Firm)
Attorneys for Defendants Clark,
Francis, Kircher, Puckett, Reavis,
Thornton and Wilde,
48 Wall Street,
New York, N. Y. 10005.
HAnover 2-8100

Answer of Defendants Robert A. Bernhard, *et al.*, to Second Amended Complaint

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

[SAME TITLE]

Defendants Robert A. Bernhard, Lucius D. Clay, Frederick L. Ehrman, Monroe C. Gutman, Robert Lehman, Paul E. Manheim, Paul M. Mazur, Alvin W. Pearson, Joseph A. Thomas, H. J. Szold, Herman H. Kahn, Morris Natelson, Edwin L. Kennedy, Frank J. Manheim, Allan B. Hunter, Marcel A. Palmaro, William H. Osborne, Jr., Arthur D. Schulte and Paul L. Davies, individually and as partners doing business under the firm name and style of Lehman Brothers, by their attorneys Simpson Thacher & Bartlett, for their answer to the second amended complaint:

First: Deny each and every allegation contained in paragraphs "1", "10", "12", "14", "15", "16", "17", "18", "20", "21", "22" and "23" of the second amended complaint.

Second: Deny that they have any knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph "2" of the second amended complaint, except that they admit that this action is not brought collusively to confer on the Court jurisdiction which it otherwise would not have.

Answer of Defendants Robert A. Bernhard, et al., to Second Amended Complaint

Third: Deny each and every allegation contained in paragraph "6" of the second amended complaint, except that they admit that Lehman Brothers is an investment banking firm, is a member firm of the New York Stock Exchange and other exchanges and that its principal office is at One William Street in the City, County and State of New York.

Fourth: Deny each and every allegation contained in paragraph "7" of the second amended complaint, except that they admit that the Chairman of the Board of Directors, the Vice Chairman of the Board of Directors, the president and the executive vice president of defendant The Lehman Corporation are also members of the firm of Lehman Brothers.

Fifth: Deny each and every allegation contained in paragraph "8" of the second amended complaint, except that they admit that defendant The Lehman Corporation is registered under the Investment Company Act of 1940, that its assets are invested almost entirely in securities of other corporations and that, for the most part, the securities held by it are listed on the New York Stock Exchange.

Sixth: Deny each and every allegation contained in paragraph "9" of the second amended complaint, except that they admit that Lehman Brothers acts as broker for defendant The Lehman Corporation with respect to most of said defendant's portfolio transactions, that Lehman Brothers receives for such brokerage services such commissions as are provided for by the rules of the stock exchanges upon which such transactions are effected, and that, in the years

1960 through 1966, the brokerage commissions incurred by defendant The Lehman Corporation, the portions of such commissions paid to Lehman Brothers and the amounts paid in turn by Lehman Brothers to other brokers, were as follows:

Year	Brokerage Commissions Incurred by The Lehman Corporation	Paid to Lehman Brothers	Paid by Lehman Brothers to other Brokers
1960	$387,490	$323,452	$30,008
1961	$635,562	$536,948	$53,969
1962	$486,163	$421,498	$42,887
1963	$371,399	$320,918	$33,251
1964	$531,724	$442,903	$48,480
1965	$538,622	$334,685	$41,688
1966	$405,772	$351,640	$43,085

Seventh: Deny that they have any knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph "11" of the second amended complaint.

Eighth: Deny each and every allegation contained in paragraph "13" of the second amended complaint, except that they admit that defendant The Lehman Corporation from time to time purchases and sells securities which are not listed on a national securities exchange, and that some of such transactions are effected for it by Lehman Brothers.

Ninth: Deny each and every allegation contained in paragraph "19" of the second amended complaint, except that they refer, for the terms thereof, to the Investment Company Act of 1940.

Answer of Defendants Robert A. Bernhard, et al., to Second Amended Complaint

Tenth: Deny each and every allegation contained in paragraph "24" (erroneously numbered "20") of the second amended complaint, except that they admit that defendant The Lehman Corporation has approximately 35,000 shareholders.

FIRST DEFENSE

Eleventh: The second amended complaint fails to state a claim upon which relief can be granted.

SECOND DEFENSE

Twelfth: The claims alleged in the second amended complaint are barred in whole or in part by the applicable Statute of Limitations or by laches.

THIRD DEFENSE

Thirteenth: The second amended complaint fails to set forth with particularity the efforts of plaintiffs to secure from the managing directors of defendant The Lehman Corporation or from the shareholders of said defendant such action as they desire or the reasons for not making such effort.

FOURTH DEFENSE

Fourteenth: Plaintiffs have not sought to secure from the managing directors of defendant The Lehman Corporation or from the shareholders of said defendant the relief sought in the second amended complaint or that an action seeking such relief be brought.

Answer of Defendants Robert A. Bernhard, et al., to Second Amended Complaint

FIFTH DEFENSE

Fifteenth: Plaintiffs have approved and ratified the acts alleged in the second amended complaint and are estopped from maintaining this action.

WHEREFORE defendants Bernhard, Clay, Ehrman, Gutman, Lehman, Manheim, Mazur, Pearson, Thomas, Szold, Kahn, Natelson, Kennedy, Manheim, Hunter, Palmaro, Osborne, Schulte and Davies, individually and as partners doing business under the firm name and style of Lehman Brothers, demand judgment dismissing the second amended complaint, together with the costs and disbursements of this action.

SIMPSON THACHER & BARTLETT

By: DANIEL G. SACKS
A Member of the Firm
Attorneys for Defendants
Bernhard, Clay, Ehrman, Gutman,
Lehman, Manheim, Mazur, Pearson,
Thomas, Szold, Kahn, Natelson,
Kennedy, Manheim, Hunter,
Palmaro, Osborne, Schulte and
Davies, individually and as
partners doing business under
the firm name and style of
Lehman Brothers
Office and P.O. Address
120 Broadway
New York 5, N. Y.
WOrth 4-1900

Answer of Defendant The Lehman Corporation to Second Amended Complaint

UNITED STATES DISTRICT COURT

For the Southern District of New York

[Same Title]

Defendant, The Lehman Corporation, by its attorneys, Walsh & Frisch, answering the amended complaint:

1. Denies each and every allegation contained in paragraphs 1, 10, 12, 14, 15, 16, 17, 20, 21, 22, and 23 of the amended complaint.

2. Denies information and knowledge sufficient to form a belief as to the allegation contained in paragraphs 2 and 18 of the amended complaint.

3. Denies each and every allegation contained in paragraph 7 of the amended complaint, except admits that the persons occupying the positions of Chairman of the Board, Vice Chairman of the Board, President and Executive Vice President of The Lehman Corporation are partners of Lehman Brothers.

4. Denies each and every allegation contained in paragraph 9 of the amended complaint, except admits that a substantial part of The Lehman Corporation portfolio transactions were executed by Lehman Brothers at commission rates which never exceed the minimum rates prescribed by the stock exchange upon which the transaction

is executed; and on information and belief, admits that during the past five years, Lehman Brothers has received commissions from The Lehman Corporation and that for the years 1964, 1965 and 1966, the brokerage commissions incurred by The Lehman Corporation were as alleged, the portion of such brokerage commissions paid to Lehman Brothers were as alleged and the portion of those commissions paid to Lehman Brothers which were then paid to other brokers were as alleged.

5. Denies each and every allegation contained in paragraph 11 of the amended complaint, except admits on information and belief that Lehman Brothers earns profits on the brokerage commissions received by it from The Lehman Corporation.

6. Denies each and every allegation contained in paragraph 13 of the amended complaint, except admits that The Lehman Corporation purchases and sells securities which are not listed on a national securities exchange from time to time and that some of these transactions are effected by Lehman Brothers.

7. Denies each and every allegation contained in paragraph 19 of the amended complaint and begs leave to refer to the Investment Act of 1940 for the true terms thereof.

8. Denies each and every allegation contained in paragraph 24 of the amended complaint (erroneously numbered "20"), except admits that The Lehman Corporation has approximately 35,000 shareholders.

Answer of Defendant The Lehman Corporation to Second Amended Complaint

FIRST AFFIRMATIVE DEFENSE

9. Plaintiffs have failed without legal excuse or justification to make demand upon the Board of Directors of The Lehman Corporation that the claim or claims alleged in the amended complaint be asserted by The Lehman Corporation.

SECOND AFFIRMATIVE DEFENSE

10. Plaintiffs have failed without legal excuse or justification to make demand upon the stockholders of The Lehman Corporation that the claim or claims alleged in the amended complaint be asserted by The Lehman Corporation.

THIRD AFFIRMATIVE DEFENSE

11. The cause or causes of action alleged in the amended complaint did not accrue within six years next prior to the commencement of the action.

FOURTH AFFIRMATIVE DEFENSE

12. The cause or causes of action alleged in the amended complaint did not accrue within three years next prior to the commencement of the action.

FIFTH AFFIRMATIVE DEFENSE

13. Plaintiffs have been guilty of inordinate delay in commencing this action and, accordingly, this action is barred by laches.

Answer of Defendant The Lehman Corporation to Second Amended Complaint

SIXTH AFFIRMATIVE DEFENSE

14. Plaintiffs have approved and ratified the acts alleged as a cause or causes of action in the amended complaint and are thereby estopped from maintaining this action.

SEVENTH AFFIRMATIVE DEFENSE

15. The claims alleged concerning "reciprocal brokerage" and "interpositioning" in paragraphs 13 through 15 and 18 and related paragraphs do not relate back to the date of the filing of the original complaint herein.

WHEREFORE, defendant The Lehman Corporation demands judgment dismissing the amended complaint, together with the costs and disbursements of this action.

WALSH & FRISCH

by E. ROGER FRISCH
(A Member of the Firm)
Attorneys for defendant The
Lehman Corporation
250 Park Avenue
New York, N. Y. 10017
MU 7-7161

Memorandum and Order

(83)

Ross v. Bernhard, et al., 65 Civ. 665
Civ. Mot. Cal. Aug. 29, 1967 No. 69

This is a stockholders' derivative action by stockholders of The Lehman Corporation against directors of that corporation and against Lehman Brothers, the corporation's broker.* The complaint charges in substance that The Lehman Corporation has paid to Lehman Brothers brokerage commissions which are excessive for a variety of reasons and that the assets of The Lehman Corporation have thereby been wasted. This is said to be a violation of the Investment Company Act of 1940 (15 U.S.C. § 80a-1 *et seq.*). Defendants Clark, Francis, Kircher, Puckett, Reavis, Thornton, and Wilde move to strike plaintiffs' demand for a jury trial.

Whether or not plaintiffs are entitled to a jury trial depends upon the answer to two questions:

(84) (1) Does the fact that this is a stockholders' derivative action, a creature of equity, in and of itself deprive plaintiffs of a trial by jury?

(2) If not, and if the question of a jury trial is to be viewed as though the corporation were suing, is the action a "suit at common law" within the meaning of the Seventh Amendment?

As to the first question, opposite conclusions were reached in *Richland* v. *Crandall*, 259 F. Supp. 274 (S.D.N.Y. 1966),

* The complaint alleges that plaintiffs also sue representatively on behalf of themselves and of other stockholders of The Lehman Corporation similarly situated. Both sides agree, however, that this action is actually purely derivative, as the only relief sought is for the benefit of The Lehman Corporation. Consequently, the representative allegation has no bearing upon the issues raised by this motion.

and *DePinto* v. *Provident Security Life Insurance Company*, 323 F. 2d 826 (9th Cir. 1963), *cert. denied*, 376 U.S. 950 (1964). In my opinion the *DePinto* view is the correct one. The court there held that although the aid of equity is needed in order to establish the stockholders' right to sue on behalf of the corporation, the claim is that of the corporation and the right to a jury trial is to be judged as though the corporation were suing. This decision gives effect to *Fleitmann* v. *Welsbach Street Lighting Co.*, 240 U.S. 27 (1916), and *Fanchon & Marco, Inc.* v. *Paramount Pictures, Inc.*, 202 F. 2d 731 (2d Cir. 1953), in which this result was reached in antitrust treble damage (85) actions. I see no reason why this rule should be peculiar to antitrust litigation. I will follow it here.

As to the second question, the allegations of the complaint are controlling. The complaint uses a number of harsh words. It charges that defendants have been guilty of "gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence and a reckless disregard of their fiduciary duties." The prayer is for a judgment "requiring the defendants jointly and severally to account for and pay to the Corporation for their profits and gains and its losses."

The fact that plaintiffs seek an accounting, a word which smacks of equity, is not determinative.

Dairy Queen, Inc. v. *Wood*, 369 U.S. 469 (1962)

Plaintiffs are seeking a money judgment. They ask that defendants "pay" to the corporation defendants' gains and the corporation's loss. The issues are not so complicated as to make it impracticable for a jury to ascertain the amount, if any, to which plaintiffs may be entitled.

(86)

It is true that the complaint employs equitable language in alleging that defendant directors have abused their trust and have disregarded their fiduciary duties. But the alleged facts which underly thes conclusions are simply that defendants have caused the corporation to pay out money which the corporation should not have paid, and that in consequence, the corporation is entitled to judgment for those moneys. This diversion of funds is alleged to be a conversion by defendants of the corporate assets. Whatever the law may formerly have been, I am persuaded that recent decisions of the Supreme Court, which have gone far in protecting the right to a jury trial under the Seventh Amendment, require the conclusion that this complaint states on behalf of the corporation a claim which is fundamentally legal rather than equitable.

Dairy Queen, Inc. v. *Wood, supra;*
Beacon Theatres, Inc. v. *Westover,* 359 U.S. 500 (1959);
See also DePinto v. *Provident Security Life Insurance Company, supra.*

(87)

Defendants' motion is denied.

So ordered.

Dated: November 3, 1967

EDWARD C. McLEAN
U.S.D.J.

Notice of Defendants' Motion to Amend and Resettle
(88)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

[SAME TITLE]

SIRS:

PLEASE TAKE NOTICE that, pursuant to 28 U.S.C. § 1292(b), the undersigned will move at a motion part of this court at 10:00 A.M. on November 28, 1967, in Room 506, United States Courthouse, Foley Square, New York, New York, for an order amending and resettling this court's memorandum and order filed November 6, 1967 by adding on page 5, an additional paragraph as follows: "The court is of the opinion that this order denying the motion of all defendants to strike plaintiffs' demand for jury trial involves a controlling question of law as to which there are substantial grounds for difference of opinion and that an immediate appeal from this order as authorized by 28 U.S.C. § 1292(b) may materially advance the ultimate determination of this litigation."

Dated: New York, New York
November 16, 1967

Yours, etc.,

SULLIVAN & CROMWELL,

By MARVIN SCHWARTZ
(A Member of the Firm)
Attorneys for Defendants
Clark, Francis, Kircher,
Puckett, Reavis, Thornton
and Wilde,
48 Wall Street, New York, N.Y. 10005

Notice of Defendants' Motion to Amend and Resettle Order Dated December 6, 1967

(89)

SIMPSON THACHER & BARTLETT

By WILLIAM J. MANNING
(A Member of the Firm)
Attorneys for Defendants
Robert A. Bernhard, et al.,
120 Broadway,
New York, N. Y. 10005

WALSH & FRISCH

By E. ROGER FRISCH
(A Member of the Firm)
Attorneys for Denfendant
The Lehman Corporation,
250 Park Avenue,
New York, N. Y. 10017

To:

ROSENTHAL & GURKIN,
Attorneys for Plaintiffs,
19 West 44th Street,
New York, N. Y. 10038

POMERANTZ, LEVY, HAUDEK & BLOCK,
Counsel for Plaintiffs,
295 Madison Avenue,
New York, N. Y. 10017.

Order Dated December 6, 1967

(94)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

[SAME TITLE]

The Court having entered an order herein on November 6, 1967 denying defendants' motion to strike plaintiffs' demand for jury trial, and defendants having moved by notice of motion dated November 16, to amend and resettle the said order of November 6, to permit interlocutory appeal pursuant to 28 U.S.C. § 1292(b).

Now, upon all of the papers and proceedings heretofore had herein, and due deliberation having been had, the Court finds that said order of November 6 involves a controlling question of law, that there are substantial grounds for difference of opinion as to this question and that an immediate appeal would materially advance the ultimate termination of this litigation and it is hereby

ORDERED that the motion of defendants be and it hereby is granted, and it is further

ORDERED that the memorandum and order filed herein on November 6, 1967 be amended to include a final paragraph as follows: "The Court is of the opinion that this order denying defendants' motion to strike plaintiffs' demand for jury trial in this stockholders' derivative action involves (95) a controlling question of law as to which there is sub-

stantial ground for difference of opinion and that an immediate appeal from this order may materially advance the ultimate termination of this litigation."

Dated: New York, New York
December 6, 1967

EDWARD C. McLEAN
U. S. D. J.

Affidavit of James B. Downing

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

[SAME TITLE]

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

JAMES B. DOWNING, being duly sworn, deposes and says:

I am Vice President and Treasurer of defendant-petitioner The Lehman Corporation (the "Corporation") on whose behalf plaintiffs allegedly bring this action. I submit this affidavit in support of petitioners' Application to this Court for review of the order of the United States District Court for the Southern District of New York (McLean, J.) entered December 7, 1967, which permits a jury trial of this case.

The Corporation is a closed-end investment company founded in 1929. At the present time the portfolio of securities of the Corporation has a value of over $500 million. During the past six years over 90% of the value of this portfolio has been made up of common stocks, the great majority of which have been listed on registered securities exchanges. The investment activity of the Corporation depends upon the purchase and sale of such securities for its portfolio.

One of the plaintiffs' claims in this case is that the Corporation should not effect transactions in listed securities

for its portfolio on registered securities exchanges, but should only buy or sell such listed securities off these exchanges in the so-called "third market". A reasonably early resolution of this far-reaching claim is desired by the Corporation. The possibility of a jury trial and appeal followed by a new trial without a jury would leave this claim open for a longer period than would be the case if the question of the form of trial is reviewed now by this Court before any trial is commenced.

Of the defendants served, Howard L. Clark, Clarence Francis, Donald P. Kircher, John W. Reavis, Charles B. Thornton, B. Earl Puckett, Frazar B. Wilde, Robert A. Bernhard, Lucius D. Clay, Paul L. Davies, Frederick L. Ehrman, Monroe C. Gutman, Robert Lehman, Paul M. Mazur and Alvin W. Pearson are directors or officers of the Corporation. As such, they are entitled to indemnification by the Corporation for expenses incurred by them in connection with the defense of this suit in accordance with the conditions set forth in Section 7 of Article II of the Corporation's by-laws. The text of this Section is as follows:

> SECTION 7. Each person who is or has been a director or officer of the Corporation shall be indemnified by the Corporation against expenses reasonably incurred by him in connection with any claim or in connection with any action, suit or proceeding to which he may be a party, by reason of his being or having been a director or officer of the Corporation. The term expenses includes amounts paid in satisfaction of judgments or in settlement other than amounts paid to the Corporation itself. The Corporation shall not however

indemnify such director or officer if there is a claim of wilful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office, unless there is an adjudication of freedom from wilful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office, except that in the case of settlement or in the case of an adjudication in which the existence of wilful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office, is not established, the Board of Directors shall, prior to authorizing reimbursement for any such settlement or adjudication, determine that the director or officer is not liable to the Corporation or its security-holders for wilful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office. Such determination by the Board of Directors, however, shall not prevent a security-holder from challenging such indemnification by appropriate legal proceedings. The foregoing right of indemnification shall be in addition to any other rights to which any such director or officer may be entitled as a matter of law.

Counsel for the Corporation and counsel for both the defendant directors affiliated with Lehman Brothers and counsel for the independent director-defendants have advised us that a jury trial of this case would require greater expenditures for preparation and trial.

The Corporation wishes to minimize the legal expenses of defendants in order to limit the Corporation's potential

obligation to indemnify the defendants for these expenses as provided in the by-laws.

The Corporation therefore opposes a jury trial of this suit and respectfully requests that this Court grant leave to appeal now the order of the District Court permitting this case to be tried by a jury.

s/ JAMES B. DOWNING

Sworn to before me this
18th day of December, 1967.

MILTON C. WINKLER
Notary Public, State of New York
No. 31-9704765
Qualified in New York County
Commission Expires March 30, 1968

Order Dated January 11, 1968

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the eleventh day of January, one thousand nine hundred and sixty-eight.

HOWARD ROSS and BERNARD ROSS, as Trustees for Lena Rosenbaum,

Plaintiffs,

v.

ROBERT A. BERNHARD, et al.,

Defendants.

It is hereby ordered that the motion made herein by counsel for the defendants The Lehman Corporation, et al., for leave to appeal under Rule 1292(b) be and it hereby is granted.

/s/ J. EDWARD LUMBARD
/s/ LEONARD P. MOORE
/s/ HENRY J. FRIENDLY
Circuit Judges

January 11, 1968

Notice of Appeal

(97)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

HOWARD ROSS and BERNARD ROSS, as Trustees for Lena Rosenbaum,

Plaintiffs,

—against—

ROBERT A. BERNHARD, et al.,

Defendants.

NOTICE IS HEREBY GIVEN that pursuant to the order of the United States Court of Appeals for the Second Circuit, dated January 11, 1968, granting leave to appeal under 28 U.S.C. 1292(b), defendants The Lehman Corporation, Howard L. Clark, Clarence Francis, Donald P. Kircher, John W. Reavis, Charles B. Thornton, B. Earl Puckett, Frazar B. Wilde, Robert A. Bernhard, Lucius D. Clay, Frederick L. Ehrman, Monre C. Gutman, Robert Lehman, Paul E. Manheim, Paul M. Mazur, Alvin W. Pearson, Joseph A. Thomas, H. J. Szold, Herman H. Kahn, Morris Natelson, Edwin L. Kennedy, Frank J. Manheim, Allan B. Hunter, Marcel A. Palmaro, William H. Osborne, Jr., Arthur D. Schulte and Paul L. Davies hereby appeal to the United States Court of Appeals for the Second Circuit from the order of this Court (McLean, J.) entered herein on December 7, 1967, amending and resettling an order entered November 6, 1967, denying defendants' motion to strike plaintiffs' demand for jury trial and to (98) transfer this case to the Non-Jury Calendar.

Dated: New York, New York
January 15, 1968

Yours, etc.,

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Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 6—September Term, 1968

(Argued September 5, 1968 Decided November 1, 1968.)

Docket No. 32118

HOWARD ROSS and BERNARD ROSS, as Trustees for

LENA ROSENBAUM,

Plaintiffs-Appellees,

—v.—

ROBERT A. BERNHARD, *et al.,*

Denfendants-Appellants.

B e f o r e :

LUMBARD, *Chief Judge,*

SMITH and ANDERSON, *Circuit Judges.*

Appeal from an order entered December 6, 1967 by McLean, *J.*, United States District Court for the Southern District of New York, denying defendants' motion to strike plaintiffs' demand for a jury trial, on the ground that the Seventh Amendment to the United States Constitution extends the right to a jury trial to stockholders' derivative actions.

Order reversed and cause remanded.

ROSENTHAL & GURKIN, New York, N. Y. (Pomerantz Levy Haudek & Block, New York, N. Y., Abraham L. Pomerantz and Richard M. Meyer, on the brief), *for Plaintiffs-Appellees.*

SULLIVAN & CROMWELL, New York, N. Y. (Marvin Schwartz and Cornelius B. Prior, Jr., on the brief), *for Defendants-Appellants, Clark, Francis, Kircher, Puckett, Reavis, Thornton and Wilde.*

SIMPSON THACHER & BARTLETT, New York, N. Y. (William J. Manning and Lawrence M. Mc Kenna, on the brief), *for Defendants-Appellants, Robert A. Bernhard, et al.*

WALSH & FRISCH, New York, N. Y. (E. Roger Frisch, on the brief), *for Defendant-Appellant, The Lehman Corporation.*

LUMBARD, *Chief Judge*:

This appeal, taken by permission, questions a district court ruling which would allow a jury trial of a stockholders' derivative action. The defendants in this diversity action appeal from a Southern District order entered November 6, 1967 denying their motion to strike plaintiffs' demand for a jury trial. On December 6, 1967, Judge McLean granted defendants' motion to resettle his order, finding that it involved "a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from this order may

materially advance the ultimate termination of this litigation." As there is a difference of views in the district court on this question, see *Richland* v. *Crandall*, 259 F. Supp. 274 (S. D. N. Y. 1966), we thereafter permitted an interlocutory appeal to be taken pursuant to 28 U. S. C. § 1292(b).

We hold that the right to a jury trial guaranteed by the Seventh Amendment to the United States Constitution does not extend to stockholders' derivative actions. Accordingly, we reverse the order of the district court.

This derivative action was brought under the Investment Company Act of 1940, 15 U. S. C. § §80a-1, et seq. Named as defendants are the Lehman Corporation, the investment company for whose benefit the suit is brought, various directors and officers of the corporation, and various partners of Lehman Brothers, an investment banking firm which acts as the investment advisor and principal broker for the corporation. Plaintiffs, stockholders of the Lehman Corporation, pray for a judgment requiring defendants to account for, and pay to the corporation, their profits and gains and its losses resulting from illegal and excessive brokerage commissions paid to Lehman Brothers. These commissions fall in three categories:

> 1) Commissions paid for carrying out transactions for the corporation on the New York Stock Exchange, despite the fact that these transactions could have been executed on the so-called "Third Market" at favorable net prices without the payment of any commissions, or executed other than on a national securities exchange with the payment of substantially smaller commissions than were paid to Lehman Brothers.

2) Commissions paid in connection with over-the-counter transactions in unlisted stocks, despite the fact that the corporation could have conducted these transactions directly with "market makers" and thus avoided paying any commissions.

3) "Reciprocal brokerage commissions" paid by the corporation for allocation to the brokers who provide investment advice to Lehman Brothers, which commissions constitute excessive compensation to Lehman Brothers under its investment advisory contract with the corporation.

The complaint further alleges that more than half of the corporations directors are affiliated with Lehman Brothers, in violation of §10(b)(1) of the Investment Company Act, 15 U. S. C. §80a-10(b)(1). The payments are alleged to constitute "an unlawful and willful conversion" by defendant partners of Lehman Brothers of the corporation's assets, and "gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence and a reckless disregard of their fiduciary duties" by the defendant officers, directors and brokers of the corporation.

The Seventh Amendment provides:

> In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

Judge McLean held that the question of whether the Seventh Amendment required this action to be tried before a jury, upon plaintiffs' demand, depended upon the nature of the corporate claim asserted derivatively by the stockholders; the Seventh Amendment was to be applied as if the corporation itself were suing. He further found that the corporate claim in this action was legal, rather than equitable, in character, being in essence a demand for a money judgment to recover the funds of the corporation converted by defendants. Thus the right to a jury trial attached to this derivative action.

Our disagreement with the court below stems from the teaching of history that the stockholder's derivative action has always been regarded as exclusively a creature of equity to which the right to a jury trial does not apply. The one previous dissent from this view, *DePinto* v. *Provident Security Life Ins. Co.*, 323 F. 2d 826 (9th Cir. 1963), *cert. denied* 376 U. S. 950 (1964), we do not find persuasive. Because of our view of the jury trial issue we have no occasion to address the question of whether the underlying corporate claim is legal or equitable in character.

In determining whether the constitutional right to a jury trial applies to a given action, the basic inquiry to be made is an historical one: At the time the Seventh Amendment was adopted was the action recognized as a "suit at Common law," as to which the right to a jury trial was to be "preserved." *Baltimore & C. Line* v. *Redman*, 295 U. S. 654, 657 (1935). Despite the merger of law and equity accomplished by the Federal Rules of Civil Procedure the right to a jury trial still applies only to actions which historically could have been brought at law. Rule 38(a), Fed.

R. Civ. P., preserves the right to a jury trial "as declared by the Seventh Amendment to the Constitution . . . " While the Supreme Court seems to have modified this historical test somewhat to take account of the precedural reforms effectuated by the Federal Rules, *Beacon Theatres* v. *Westover,* 359 U. S. 500, 508-11 (1959), for reasons stated below we do not believe that this modification affects the outcome of this case.

The authorities are agreed that the stockholders' derivative action did not evolve until well after the adoption of the Seventh Amendment in 1791. *See,* e.g., Prunty, *The Shareholders' Derivative Suit: Notes on Its Derivation,* 32 N. Y. U. L. Rev. 980, 981, 986 (1957). This fact does not, as defendants suggest, foreclose the possibility that derivative actions fall within the scope of the Seventh Amendment. In instances where either Congress or the courts have evolved a new remedy subsequent to the adoption of the Amendment it is to be analogized to its nearest historical counterpart, at law or equity, for the purposes of determining whether a right to jury trial exists. *See* 5 Moore, Federal Practice ¶38.11[7], at 125 (2nd ed. 1968); James, *Right to a Jury Trial in Civil Actions,* 72 Yale L. J. 654, 655 (1963). No tortuous process of historical analogy is required in this case, however, for it is clear that the derivative action was an invention of equity.

At law stockholders could not bring a suit in the corporation's name for the vindication of a corporate right because, apparently, such legal standing was regarded as incompatible with the limited liability for the corporation's debts enjoyed at law by the stockholders. Note, *The Right to a Jury Trial in a Stockholder's Derivative Action,* 74

Yale, L. J. 725, 729 (1965). Beginning early in the Nineteenth Century equity began to recognize the derivative action, initially in order to provide a remedy against alleged wrongdoers to the corporation who also controlled its management and consequently refused to allow a suit by the corporation against themselves. *Taylor* v. *Miami Exporting Co.*, 5 Ohio 162 (1831); *Robinson* v. *Smith*, 3 Paige Ch. *222, *233 (N. Y. 1832) (dictum); *see* generally *Koster* v. *Lumbermens Mut. Co.*, 330 U. S. 518, 522 (1947). The remedy soon was extended to instances where the stockholders were seeking to enforce a corporate right against an outsider. *Dodge* v. *Woolsey*, 59 U. S. (18 How.) 331, 341-44 (1855); cf. *Forbes* v. *Whitlock*, 3 Ed. Ch. 446 (N. Y. 1841).

From these early suits to the present day the equitable nature of the derivative action has not been disputed. See *Dodge* v. *Woolsey*, 59 U. S. (18 How.) 331, 341 (1855); *Cohen* v. *Beneficial Loan Corp.*, 337 U. S. 541, 548 (1949). Likewise, with the sole exception of the *DePinto* decision, *supra*, there has been no significant dissent from the conclusion that the equitable nature of the action excludes it from the purview of the Seventh Amendment's jury trial guarantee. E.g., *Richland* v. *Crandall*, 259 F. Supp. 274 (S. D. N. Y. 1966); 5 Moore, Federal Practice ¶38.38[4], at 305-06 (2nd ed. 1968); 2 Hornstein, Corporation Law and Practice, ¶730 (1959); 13 Fletcher, Private Corporations, §5931 (Rev. ed. 1961); Note, *The Right to a Jury Trial in a Stockholder's Derivative Action*, 74 Yale L. J. 725, 732 n. 35 (1965) (citations to state court decisions under constitutional provisions similar to Seventh Amendment).

The court below, despite this impressive authority against the right to jury trial in derivative actions, reached a contrary result. It pointed out that a derivative action is composed of two distinct claims: 1) the stockholders' claim against the corporation for its refusal to sue in its own name, and 2) the underlying claim put forward for the corporation's benefit. The court held that while it must rule on the equitable issue of the stockholders' right to sue in the corporation's stead, there is no reason to refuse a demand for a jury trial on the underlying corporate claim if it is legal in character.

Other than the *DePinto* case the only supporting authorities cited by the court for its conclusion are *Fleitman* v. *Welsbach Street Lighting Co.*, 240 U. S. 27 (1916), and *Fanchon & Marco, Inc.* v. *Paramount Pictures, Inc.*, 202 F. 2d 731 (2d Cir. 1953). Both suits concerned derivative suits seeking treble damages under the Sherman Act. In the brief *Fleitman* opinion by Justice Holmes the court held that a derivative action would not lie, and for a reason which provides analogous support for defendants in this case. Justice Holmes pointed out that there could be no right to a jury trial in the equitable derivative action. Since he read the Sherman Act as requiring that treble damage actions be tried before a jury the Justice concluded that the derivative action could not be maintained.

Judge Clark's opinion in *Fanchon & Marco* did hint, entirely as dictum, that a jury trial could be demanded by a stockholder suing derivatively for treble damages. Since the jury trial issue does not appear to have been directly presented to the court we do not regard *Fanchon & Marco* as persuasive authority on this point. Moreover, whatever

was said in that opinion relates only to the *statutory* right to jury trial created by the Sherman Act, a fact made clear by the court's reliance on *Fleitman*. We deal here with the constitutional right to a jury trial. The accommodation suggested in *Fanchon & Marco* between the Sherman Act's requirement of a jury trial and the equitable nature of derivative actions is not relevant to our case, where no statutory right exists.[1]

On appeal plaintiffs urge the relevance of two Supreme Court cases construing the Seventh Amendment, *Beacon Theatres, Inc.* v. *Westover*, 359 U. S. 500 (1959), and *Dairy Queen, Inc.* v. *Wood*, 369 U. S. 469 (1962). Neither case is in point.

In *Beacon Theatres* the plaintiff, a theatre operator, alleged that he was being damaged by defendant's threat to file a treble damage action under the antitrust laws challenging the legality of plaintiff's exclusive "first run" contracts with motion picture distributors. Plaintiff sought an injunction against the threatened suit and a declaration that the contracts did not violate the antitrust laws. Defendant counterclaimed for treble damages on the ground that the contracts were illegal.

The Supreme Court noted that both the plaintiff's suit and the defendant's counterclaim revolved around the exact same issue: Were plaintiff's contracts in violation of the antitrust laws? The question, then, was whether plaintiff, by bringing a declaratory action for injunctive relief before

[1] Plaintiffs on appeal make a fleeting argument in their brief that the Investment Company Act should be read as creating a statutory right to a jury trial. Brief for plaintiffs, p. 5. This question was not raised in the court below; and the record before us is not sufficient to enable this court to address the issue.

defendant could bring his law action for treble damages, thereby could deprive defendant of his right to have the antitrust issue tried before a jury. It was no surprise that the court said no; the common issue on which both the equitable and legal relief depended must be tried on the law side in order that the right to jury trial not be defeated altogether. *See* 359 U. S. at 504; James, *Right to a Jury Trial in Civil Actions*, 72 Yale L. J. 655, 687-90 (1963).

We have no such "race to the courthouse" situation in our case. Plaintiffs have lost no right to a jury trial they would have possessed had this issue been litigated at law; were it not for equity, plaintiffs would not be in court at all. In *Beacon Theatres* equity was invoked only to anticipate and defeat the assertion of a legal claim. Here equity grants to plaintiffs their capacity to sue, not merely an alternative form of relief. It is from the fountainhead of equity that this entire litigation flows, and we see no justification for artificially dividing the suit into two parts for the purposes of applying the Seventh Amendment. *See*, Note, *The Right to a Jury Trial in a Stockholder's Derivative Action*, 74 Yale L. J. 725, 729-32 (1965).

In *Dairy Queen, Inc.* v. *Wood*, 369 U. S. 469 (1962), the plaintiff sued for trademark infringement and sought both an accounting, which the Court viewed as a claim essentially legal in character, and an injunction. Once again the Court was confronted by two claims for relief which turned on the same issue. If the claim for an injunction were tried first the principle of collateral estoppel would bar a second trial, before a jury, on the legal claim for damages. In these circumstances the court held that the right to a jury trial could not be defeated by labeling the

legal claim "incidental" to the equitable claim and trying the latter claim first; rather the jury trial on the issue of damages must be given priority.

Unlike *Dairy Queen*, the complaint in this case does not merely join two claims which could have been presented in separate suits. Rather, the assertion of any "legal" claim on behalf of the corporation is totally dependent upon plaintiffs' successfully establishing their capacity to sue at equity. Thus in applying the Seventh Amendment the two portions of the complaint cannot be regarded as separable and divisible. Cf. *Robine* v. *Ryan*, 310 F. 2d 797, 798 (2d Cir. 1962).

The Supreme Court in *Beacon Theatres* and *Dairy Queen* did modify the historical test for applying the Seventh Amendment in one respect. The court noted that a prerequisite for equity jurisdiction has always been that no adequate remedy at law exists. One application of this rule concerned the "clean-up" power of an equity court; for the convenience of the parties, and to protect rights which might be jeopardized through the delay which would be caused by requiring an additional suit at law, equity courts whose jurisdiction had been properly invoked by an equitable claim would also dispose of related legal issues. This procedure, which operated to deny a jury trial of those related legal issues, is no longer justified in light of the liberal joinder provisions of the Federal Rules of Civil Procedure. Under the Rules a judge can have the legal issues tried first before a jury, and then immediately decide the equitable issues himself. There is no danger of jeopardizing rights through delay. Thus the court has held that the scope of equitable jurisdiction has declined

pro tanto as the adequacy of legal relief has increased through the procedural reforms of the Federal Rules. *Beacon Theatres, Inc.* v. *Westover*, 359 U. S. 500, 509 (1959).

This modification of the Seventh Amendment standard does not affect the determination of this case. Equity courts have not exercised jurisdiction over the underlying corporate claims in derivative suits pursuant to their clean-up power, but rather because law has never recognized suits brought by stockholders for their corporation's benefit. The derivative action analytically may be composed of two parts, but before the courts it has always been treated as one, unitary action brought at equity. *See* Note, *The Right to a Jury Trial in a Stockholder's Derivative Action*, 74 Yale L. J. 725, 729-32 (1965).

It is argued that refusing to extend the right to jury trial to derivative actions will cause anomalous results in cases where it is the defendant who demands a jury trial. The plaintiffs point out that while such a defendant would be entitled to a jury trial if the corporation itself brings a legal claim against him, he is, in plaintiffs' words, "cheated out" of his jury if the action is brought derivatively by the stockholders. But if a corporation and its stockholders conspire to have a claim brought derivatively, rather than by the corporation, for the purpose of depriving defendant of a jury trial, his rights can be protected by a remedy less severe than a far-reaching extension of the Seventh Amendment. The refusal of a corporation to sue in its own name in order to avoid a jury trial would violate the spirit of Rule 23.1, Fed. R. Civ. P., and there would be no basis for invoking the jurisdiction of equity to hear a derivative action. Of course no danger of collusion is present in

this case since all defendants are resisting plaintiffs' attempt to secure a jury trial.

As for the anomaly plaintiffs claim to perceive arising from the denial of a jury trial, it has existed since the very origin of the derivative action. We are aware of no great agitation among potential litigants or the bar concerning the traditional rule against jury trials in derivative actions.

It may well be that juries, perhaps with the aid of a master, see *Dairy Queen, Inc.* v. *Wood*, 369 U. S. 469, 478 (1963), are perfectly competent to try derivative actions, although we entertain some doubt on this point because of the exceedingly complex nature of many of these actions. But the Seventh Amendment does not ask that we assess the suitability of a given type of litigation for jury trial. In addition to invoking a judicially unmanageable standard, *see* James, *Right to a Jury Trial in Civil Actions*, 72 Yale L. J. 655, 690-91 (1963), such an inquiry would violate the Amendment's instruction that we "preserve," i.e., neither expand nor contract, the constitutional right to a jury trial. After all, there is little practical reason why a jury could not try many suits for injunctions.

The historical test established by the Seventh Amendment may be artificial from a functional point of view. But it satisfies the basic purpose of its drafters of safeguarding from erosion the right to jury trials which existed at the time of its adoption. Applying this test in this case we hold that a stockholders' derivative action is not a "suit at common law" to which the right to jury trial extends.

SMITH, *Circuit Judge* (dissenting):

I dissent. I would affirm the order denying the motion to strike the demand for jury trial. The underlying claim

is essentially "a suit at common law," an action for a money judgment for unlawful conversion, breach of fiduciary duty, fraud and gross negligence. It would have been apt for jury consideration had the corporation itself sued. The issues are not so complex as to be beyond the competence of a trial jury. Cf. *Dairy Queen* v. *Wood*, 369 U. S. 469, 479 (1962). The fact that historically it was necessary for the shareholder to resort to equity in order to step into the corporation's shoes (*Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U. S. 541, 548 (1949)), should no longer bar jury trial of the corporate claim. The reason for the denial of jury is eliminated through the provision by the federal rules of one civil action in which the issues of the right of the shareholder to sue and of violation of fiduciary duty causing damage to the corporation may "be tried side by side or otherwise as may be convenient; that one may go to the jury while the other does not cause no difficulty," *Fanchon & Marco* v. *Paramount Pictures*, 202 F. 2d 731, 735 (2d Cir. 1953). I would agree with the result reached by the Ninth Circuit in *DePinto* v. *Provident Security Life Ins. Co.*, 323 F. 2d 826 (9 Cir. 1963), cert. denied 376 U. S. 950, rehearing denied 383 U. S. 973.

Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the first day of November one thousand nine hundred and sixty-eight.

Present:

HON. J. EDWARD LUMBARD,
Chief Judge.

" J. JOSEPH SMITH,

" ROBERT P. ANDERSON,
Circuit Judges.

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,
Plaintiffs-Appellees,

v.

ROBERT A. BERNHARD, et. al.,
Defendants-Appellants.

Judgment of the Court of Appeals

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and that the action be and it hereby is remanded for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellees.

A true copy.

A. Daniel Fusaro
Clerk

Supreme Court of the United States

No. 992 ---- , *October Term, 19* 68

Howard Ross and Bernard Ross, as Trustees for Lena Rosenbaum,

Petitioners,

v.

Robert A. Bernhard et al.

ORDER ALLOWING CERTIORARI. Filed March 24 ---------- , 19 69

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second ---------- Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

IN THE

Supreme Court of the United States

OCTOBER TERM 1968

Office-Supreme Court, U.S.
FILED
JAN 29 1969
JOHN F. DAVIS, CLERK

No. [redacted] 42

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,

Petitioners,

—against—

ROBERT A. BERNHARD
HOWARD L. CLARK
CLARENCE FRANCIS
DONALD P. KIRCHER
PAUL E. MANHEIM
JOHN W. REAVIS
FRAZAR B. WILDE
MORRIS NATELSON
FRANK J. MANHEIM
MARCEL A. PALMARO
LUCIUS D. CLAY
FREDERICK L. EHRMAN
MONROE C. GUTMAN
ROBERT LEHMAN
PAUL M. MAZUR
ALVIN W. PEARSON
CHARLES B. THORNTON
JOSEPH A. THOMAS
H. J. SZOLD
HERMAN M. KAHN
EDWIN L. KENNEDY
ALLAN B. HUNTER
WILLIAM H. OSBORNE, JR.
and THE LEHMAN CORPORATION

Respondents,

and

PAUL L. DAVIES
JAMES K. HART
THOMAS A. MORGAN
T. S. PETERSEN
ARTHUR D. SCHULTE
ERNEST B. BREECH
JAMES M. HESTER
B. EARL PUCKETT

Defendants.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

Supreme Court of the United States

October Term 1968

No.

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,

Petitioners,

—against—

ROBERT A. BERNHARD, et al.,

Respondents,

and

PAUL L. DAVIES, et al.,

Defendants.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Howard Ross and Bernard Ross, as Trustees for Lena Rosenbaum, Plaintiffs-Appellees below, petition for a writ of certiorari to review the judgment of the Court of Appeals for the Second Circuit. The judgment is dated and was entered November 1, 1968 (App. 18-19).

Opinions Below

The opinion of the District Court for the Southern District of New York is reported at 275 F. Supp. 569. The opinion of the Second Circuit has not yet been reported (App. 4-17).

Jurisdiction

The District Court's jurisdiction was based upon the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1, et seq. The jurisdiction of the Court of Appeals was based

on 28 U.S.C. § 1292(b), that Court having accepted a certification from the District Court. This Court's jurisdiction is based on 28 U.S.C. § 1254(1).

Question Presented

When a corporate action to recover money entitles all parties to a jury trial, is the jury right lost where the corporation is compelled to seek relief at the instance of a stockholder in a derivative action?

Constitutional Provisions and Statutes

Seventh Amendment to the Constitution:

> "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law."

Section 44 of the Investment Company Act of 1940, 15 U.S.C. § 80a-43:

> "Sec. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. . . ."

Statement of the Case

This is an action brought by stockholders of The Lehman Corporation in its right and on its behalf. It is brought under the Investment Company Act of 1940, 15 USC § 80a-1, et seq. The amended complaint alleges that the Corporation, under the control of its broker, Lehman Brothers, has paid illegal and unnecessary brokerage commissions to Lehman Brothers. The plaintiffs made timely demand for a jury trial. Pre-trial discovery was completed, plaintiffs filed a note of issue and the action was placed upon the trial calendar. Defendants then moved to strike plaintiffs' demand for jury trial and to transfer the case to the non-jury calendar. The District Court denied defendants' motion, but certified the question to the Court of Appeals for the Second Circuit, which accepted the certification. The Second Circuit, in a two-to-one opinion, reversed the District Court.

Reasons for Granting the Writ

A. A conflict between the Second and Ninth Circuits on the issue of the right to a jury trial in stockholders' derivative cases requires resolution by this Court.

The Court of Appeals for the Second Circuit has held here that there is no right to a jury trial in a stockholder's derivative action to recover money damages. This decision is, acknowledgedly, in head-on collision with that of the Court of Appeals for the Ninth Circuit, which holds that a jury trial does lie in a stockholder's derivative action. (*DePinto* v. *Provident Security Life Insurance Co.*, 323 F.2d 826 (9 Cir. 1963), cert. den. 376 U.S. 950, reh. den. 383 U.S. 973).

Early resolution by this Court of the conflict between the circuits is necessary to prevent a confusion of conflicting adjudications throughout the country as well as a great loss of the time of District Courts and Courts of Appeals. There are presently pending, in the district courts encompassed by the Second and the Ninth Circuits and in other circuits around the country, a great many stockholder's derivative actions. In several of them the issue of the right to a jury trial is pending undetermined.*

Unless certiorari is granted here, the cases pending in the districts covered by the Second Circuit will proceed, as the present case must over the objection of plaintiffs, to lengthy trials without juries. If this court ultimately determines to follow the Ninth Circuit decision in *DePinto*, the parties in derivative cases in the Second Circuit will have been deprived of jury trials; all those cases may have to be retried, thus adding to the congestion of an already badly congested calendar. Similar problems will arise in the other circuits around the country which will, unless guided by the decision of this Court, have to choose between the opposite rules of the Ninth and Second Circuits. The grant of certiorari here is the only way to prevent a staggering waste of judicial time and litigants' money.

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* Thus, in the Southern District of New York, a random sampling indicates that juries have been demanded in the following stockholder's derivative cases: *Fogel* v. *Chestnutt*, 67 Civ. 60; *Fogel* v. *Chestnutt*, 68 Civ. 2885; *Saperstone* v. *Kapelow*, 67 Civ. 3262; *Waxman* v. *Youngman*, 65 Civ. 684; *Schwartz* v. *Starr*, 65 Civ. 735; *Gluck* v. *Bell*, 65 Civ. 693; *Polack* v. *Starr*, 65 Civ. 832; *Newman* v. *Stein*, 68 Civ. 1398; *Zeitlin* v. *Bergen*, 66 Civ. 4479; *Goodman* v. *von der Heyde*, 68 Civ. 973; and *Rittenberg* v. *Chalker*, 68 Civ. 438. In the Northern District of California, a jury has been demanded in *Norman* v. *McKee*, No. 23489.

B. The Court of Appeals decision of a fundamental constitutional question is in conflict with applicable decisions of this Court.

As the District Court here recognized, a stockholder's derivative action is constituted essentially of two parts. The first part concerns the shareholder's right to maintain the action on behalf of the corporation. This question, it may be conceded, is a matter of equity. The second part is the underlying claim of the corporation asserted in the action. This claim may be either legal or equitable depending upon its nature. *Koster* v. *Lumbermens Mutual Cas. Co.*, 330 U.S. 518, 522-23 (1947); *Meyer* v. *Fleming*, 327 U.S. 161, 168 (1946).

Prior to the union of law and equity, an equity court, once having taken jurisdiction, would proceed to final adjudication of all issues, legal and equitable, in the single suit in equity. The adoption of the Federal Rules of Civil Procedure in 1938 worked a historical change by merging law and equity into a single unified system. The artificial restraints of the old system were eliminated. It now became possible for a litigation to be tried before a single judge sitting at once as a law court trying the legal issues with a jury if demanded, and an equity court trying the equity issues.

The Court of Appeals below analyzed this case by utilizing pre-merger concepts: It noted that a derivative action, under the pre-unified system, would have had to be instituted in equity and an equity court would have decided the entire case without reference to a jury. Therefore, it held, no right to trial by jury is ever present in a stockholder's derivative action, even though the underlying corporate claim be legal rather than equitable.

This Court, however, rejected just such a test in *Beacon Theatres, Inc.* v. *Westover,* 359 U.S. 500 (1959). In that case, plaintiff sought an injunction and defendant counterclaimed for treble damages under the antitrust laws. This Court held that if legal claims were present, a jury was required; the blending of legal and equitable claims, which formerly would have resulted in equity jurisdiction, does not now destroy the right to a jury trial of the legal issues.

> " * * * 'Maintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence that any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care.'
>
> " * * * Since in the federal courts equity has always acted only when legal remedies were inadequate, the expansion of adequate remedies provided by the Declaratory Judgment Act and the Federal Rules necessarily affects the scope of equity. Thus, the justification for equity's deciding legal issues once it obtains jurisdiction, and refusing to dismiss a case, merely because subsequently a legal remedy becomes available, must be re-evaluated in the light of the liberal joinder provisions of the Federal Rules which allow legal and equitable causes to be brought and resolved in one civil action." (359 U.S. at 501, 509)

In *Dairy Queen, Inc.* v. *Wood,* 369 U.S. 469 (1962), this Court emphatically reaffirmed its holding in *Beacon Theatres.* In *Dairy Queen,* the complaint alleged that the defendant was infringing the plaintiff's trademark and had breached a licensing agreement between the parties; it sought an injunction and an accounting. These were all, historically and traditionally, "equitable" claims—just as

the stockholder's derivative action is traditionally "equitable". Nonetheless, this Court held that, since money recovery was also sought, the right to jury trial is not destroyed. The Court stated:

> "The holding in Beacon Theatres was that where both legal and equitable issues are presented in a single case, 'only under the most imperative circumstances, circumstances which in view of the flexible procedures of the Federal Rules we cannot now anticipate, can the right to a jury trial of legal issues be lost through prior determination of equitable claims.'[7] That holding, of course, applies whether the trial judge chooses to characterize the legal issues presented as 'incidental' to equitable issues or not.[8] Consequently, in a case such as this where there cannot even be a contention of such 'imperative circumstances', Beacon Theatres requires that any legal issues for which a trial by jury is timely and properly demanded be submitted to a jury. There being no question of the timeliness or correctness of the demand involved here, the sole question which we must decide is whether the action now pending before the District Court contains legal issues." (369 U.S. at 472-73)

"7. Id. 359 U.S. at 510, 511.

8. 'It is therefore immaterial that the case at bar contains a stronger basis for equitable relief than was present in Beacon Theatres. It would make no difference if the equitable cause clearly outweighed the legal cause so that the basic issue of the case taken as a whole is equitable. As long as any legal cause is involved the jury rights it creates control. This is the teaching of Beacon Theatres, as we construe it.' Thermo-Stitch, Inc. v. Chemi-Cord Processing Corp. (CA5 Fla.) 294 F.2d 486, 491."

In the present case the Court of Appeals denied the right to a jury because "the assertion of any 'legal' claim on behalf of the corporation is totally *dependent* upon plain-

tiffs' successfully establishing their capacity to sue at equity. Thus, in applying the Seventh Amendment the two portions of the complaint cannot be regarded as separable and divisible." (App. 14) (emphasis supplied).

But this effort to distinguish this court's holdings in *Beacon Theatres* and in *Dairy Queen* does not withstand analysis. For the holding of these cases is that, where both legal and equitable issues are presented in a single case, the right to a jury trial must not be lost by the way in which "the trial judge chooses to characterize the legal issues" (*Dairy Queen, supra,* 369 U.S. at 473). In *Dairy Queen,* the trial court denied a jury, denigrating the legal issue by characterizing it as merely "incidental" to the equitable issue (369 U.S. 469, 470). In the present case, the Court of Appeals rationalizes denial of a jury by referring to the legal issue as "dependent" on the equitable issues. However the legal issue be labeled, it is unquestioned that there *is* a legal issue here. And this court has laid down the rules in terms so broad as to reject semantic erosion: "only under the most imperative circumstances . . . can the right to a jury trial of legal issues be lost through prior determination of equitable claims" *Beacon Theatres, supra* (359 U.S. at 510-511). If indeed the right to a jury trial should depend on such elusive and unfunctional a concept as would require balancing the weight of the equity claim against that of the law claim, it is nevertheless plain that the dominant claim in most derivative cases is the underlying corporate claim. The fact that equity has fashioned a remedy which enables any shareholder of a corporation, immobilized by recreant directors, to rescue the corporation and bring it to the Courthouse should not deprive the corporation or, for that matter, the defendants, of their right to a jury trial.

Thus, this Court has recognized that the important issue in stockholders' derivative actions is not the equitable question of whether the particular stockholder is entitled to maintain the action but, rather, the underlying substantive legal claim against the defendants. "The cause of action which such a [derivative] plaintiff brings before the Court is not his own but the Corporation's. It is the real party in interest and he is allowed to act in protection of its interest somewhat as a 'next friend' might do for an individual, because it is disabled from protecting itself"; *Koster* v. *Lumbermens Mutual Cas. Co.*, 330 U.S. 518, 522-3 (1947). "The fact that [in a stockholder's derivative action] the corporation is nominally a defendant * * * gives the suit only a difference in form, not a difference in substance"; *Meyer* v. *Fleming*, 327 U.S. 161, 168 (1946).

C. The Ninth Circuit decision in DePinto is consonant with the decisions of this Court.

1. *The right to jury trial in a derivative stockholders' action.*

The exact issue passed upon by the Court of Appeals was decided in 1963 by the Ninth Circuit in *DePinto* v. *Provident Security Life Insurance Co.*, 323 F. 2d 826 (9 Cir. 1963), cert. den. 376 U.S. 950, reh. den. 383 U.S. 973. In *DePinto*, the Court held that the right to a jury trial must be preserved in a stockholder's derivative action where such right would have existed had the suit been brought by the corporation in the first instance. The Court stated:

> "Thus, except under most imperative circumstances, a right to a jury trial on legal issues may not now be denied to a federal litigant on the ground that the case reached court only through equity, or because equitable rights are involved, or because the

legal issues are 'incidental' to the equitable issues, or because substantive equitable remedies are sought, or by the device of trying the equitable issues first.

"A stockholder's derivative action is an invention of equity to supply the want of an adequate remedy at law to redress breaches of fiduciary duty. Koster v. Lumbermens Mutual Casual Co., 330 U.S. 518, 522, 67 S. Ct. 828, 91 L. Ed. 1067. The aid of equity is needed in order to establish the shareholder's right to sue in the corporate stead. Fanchon & Marco, Inc. v. Paramount Pictures, Inc., 2 Cir., 202 F. 2d 731, 734, 36 A.L.R. 2d 1336. But the claim set up is that of the corporation.

"In order to determine whether appellants were entitled to a jury trial in this derivative action, it is therefore necessary to ascertain whether any of the claims asserted against them on behalf of the corporation are of a kind which, if asserted by the corporation, would be cognizable in a suit at common law. If so, and if the judgment which has been entered, insofar as can be determined rests on claims of that kind, there has been a denial of trial by jury as guaranteed by the Seventh Amendment and appellants have been aggrieved thereby." (323 F. 2d at 836-37)

The Court of Appeals below made no attempt to distinguish *DePinto*. It merely commented that the Ninth Circuit's decision was not "persuasive". (App. 8).*

* The sole federal judicial authority which the majority of the panel below was able to cite for the proposition that there is no right to jury trial in a derivative action is the District Court decision in *Richland* v. *Crandall*, 259 F. Supp. 274 (SDNY 1966). The Court's statement in *Richland* that there is no right to a jury trial in a derivative stockholder's action was academic since the court allowed a jury, the case was tried to a jury and the Court adopted the jury's findings. See *Richland* v. *Crandall*, 262 F. Supp. 538, 543 (SDNY 1967).

2. The nature of the underlying claim.

In the present case the District Court found—and the Court of Appeals did not challenge that finding—that the underlying claim of the corporation involves legal causes of action. The complaint, in brief, attacks the commissions received from the corporation by its broker. The defendants are charged with negligence, violations of the Investment Company Act and conversion of the corporation's assets. These causes of action are all cognizable at common law. 5 Moore, *Federal Practice*, ¶. 38.11[5] (2d Ed. 1967); *Simler* v. *Conner*, 372 U.S. 221 (1963); *Schultz* v. *Manufacturers & Traders Trust Co.*, 128 F. 2d 889 (2 Cir. 1942), cert. den. 317 U.S. 674; *Restatement of Agency*, 2d, §§ 399 *et seq.*

The Court of Appeals for the Third Circuit held in *Kelly* v. *Dolan*, 233 Fed. 635, 637 (3 Cir. 1916):

> "That the negligence of a director is an injury to his corporation, and that the right to recover for such negligence is a legal as contrasted with an equitable right, and that the corporation is vested with the right to recover for such injury, is established by authority. In some cases, this right is asserted in equity; in some at law, according to circumstances; but in whatever form it is litigated the right to recover for negligence is a legal right."

In *DePinto* the Ninth Circuit held:

> "Having in mind the necessity of scrutinizing, with utmost care, any seeming curtailment of the right to a jury trial, we hold that where a claim of breach of fiduciary duty is predicated upon underlying conduct, such as negligence, which is actionable in a direct suit at common law, the issue of whether there has been such a breach is, subject to appropriate instruc-

> tions, a jury question. We therefore conclude that, in the context of this case, the question concerning breach of fiduciary duty, as well as negligence, should have been submitted to the jury. * * *" (*DePinto* v. *Provident Security Life Insurance Co.*, 323 F. 2d 826, 837 (9 Cir. 1963), cert. den. 376 U.S. 950, reh. den. 383 U.S. 973.)

See also *Halladay* v. *Verschoor*, 381 F. 2d 100, 109 (8 Cir. 1967).

That the prayer for relief in the complaint asks that the defendants be required to "account for and pay to the Corporation for their profits and gains and its losses", does not alter the nature of the claim. As this Court stated in *Dairy Queen*:

> "The respondents' contention that this money claim is 'purely equitable' is based primarily upon the fact that their complaint is cast in terms of an 'accounting;' rather than in terms of an action for 'debt' or 'damages'. But the constitutional right to trial by jury cannot be made to depend upon the choice of words used in the pleadings. . . . The legal remedy cannot be characterized as inadequate merely because the measure of damages may necessitate a look into petitioner's business records." (369 US at 477-79).

D. The decision of the Court of Appeals is in conflict with a prior decision of a different panel of the same Court.

In Fanchon & Marco, Inc. v. *Paramount Pictures, Inc.*, 202 F. 2d 731 (2 Cir. 1953), the Court of Appeals held that in a derivative action where the underlying cause of action charges violation of the antitrust laws, there is a right to a jury trial which is not destroyed by the fact that the action may be brought derivatively:

> " . . . The two major issues of right of the shareholder to sue and of violation of the antitrust laws causing damage of the corporation can be tried side by side or otherwise as may be convenient; that one may go to the jury while the other does not causes no difficulty." (202 F. 2d at 735)

The Court of Appeals here thought that that prior holding was dictum. Clearly, it was not. The defendants had successfuly obtained dismissal of the action by the District Court. They argued that they were entitled to a jury trial and that under the rationale of *Fleitmann* v. *Welsbach Street Lighting Co.*, 240 U.S. 27 (1916), decided prior to the merger of law and equity, a jury trial was not available in a derivative stockholders' action. This, it was urged, required dismissal of the action. The Court of Appeals in *Fanchon* held, however, that the *Fleitmann* rationale did not apply to a merged system of law and equity and that the derivative action could be maintained while still preserving defendants' right to a jury trial.

The Court of Appeals here sought to distinguish *Fanchon* in that the underlying claim there was for treble damages under the antitrust laws. Thus, said the Court of Appeals, the jury trial right was statutory in *Fanchon* whereas here it is constitutional. This attempt at distinction misses the mark. In the first place, the right to a jury in an antitrust action is not provided by the statute but results from the fact that—as in the present case—a money judgment for damages may result. If the availability of such a judgment means that the statute contemplates a jury trial, then it must be said that § 44 of the Investment Company Act, 15 USC § 80a-43, which authorizes actions at law to enforce liabilities created by the act, similarly

confers a jury right.* More importantly, however, it is difficult to see how a statutorily created right relating to the underlying cause of action could achieve greater sanctity than a similar constitutionally provided one. In short, the *Fanchon* case cannot be distinguished; and the conflict of panels in the Second Circuit is a further reason calling for resolution by this Court. *Dickinson* v. *Petroleum Conversion Corp.*, 338 U.S. 507, 508 (1950); *John Hancock Mutual Life Ins. Co.* v. *Bartels*, 308 U.S. 180, 181 (1939).

If the Court of Appeals' overruling of *Fanchon* is permitted to stand, then the Second Circuit will be thrown back to the pre-1938 rule of *Fleitmann*. The consequence would be that defendants, sued for damages for violation of federal statutes, will be able to procure dismissal of derivative stockholders' actions simply by insisting on their rights to trial by jury. Thus would be lost "a most effective weapon in the enforcement" of federal legislation. *J. I. Case* v. *Borak*, 377 U.S. 426, 432 (1964).

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* Contrary to the suggestion made by the Court of Appeals, (App. 12, n. 1), the contention that the Investment Company Act authorizes actions at law which involve jury rights was pressed both in the District Court and in the Court of Appeals.

CONCLUSION

The decision of the Court of Appeals is in conflict with decisions of this Court, Courts of Appeal of other circuits, and prior panels of the Second Circuit. The decision is a denial of a fundamental constitutional right. If permitted to stand it would have grave consequences not only for the constitutional right of trial by jury. It would also lead to immunization of violators of federal statutes from redress in derivative stockholder's action.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

Opinion of the District Court

Ross v. Bernhard, et al., 65 Civ. 665
Civ. Mot. Cal. Aug. 29, 1967 No. 69

This is a stockholders' derivative action by stockholders of The Lehman Corporation against directors of that corporation and against Lehman Brothers, the corporation's broker.* The complaint charges in substance that The Lehman Corporation has paid to Lehman Brothers brokerage commissions which are excessive for a variety of reasons and that the assets of The Lehman Corporation have thereby been wasted. This is said to be a violation of the Investment Company Act of 1940 (15 U.S.C. § 80a-1 *et seq.*). Defendants Clark, Francis, Kircher, Puckett, Reavis, Thornton, and Wilde move to strike plaintiffs' demand for a jury trial.

Whether or not plaintiffs are entitled to a jury trial depends upon the answer to two questions:

(1) Does the fact that this is a stockholders' derivative action, a creature of equity, in and of itself deprive plaintiffs of a trial by jury?

(2) If not, and if the question of a jury trial is to be viewed as though the corporation were suing, is the action a "suit at common law" within the meaning of the Seventh Amendment?

As to the first question, opposite conclusions were reached in *Richland* v. *Crandall*, 259 F. Supp. 274 (S.D.N.Y. 1966),

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* The complaint alleges that plaintiffs also sue representatively on behalf of themselves and of other stockholders of The Lehman Corporation similarly situated. Both sides agree, however, that this action is actually purely derivative, as the only relief sought is for the benefit of The Lehman Corporation. Consequently, the representative allegation has no bearing upon the issues raised by this motion.

and *DePinto* v. *Provident Security Life Insurance Company*, 323 F. 2d 826 (9th Cir. 1963), *cert. denied*, 376 U.S. 950 (1964). In my opinion the *DePinto* view is the correct one. The court there held that although the aid of equity is needed in order to establish the stockholders' right to sue on behalf of the corporation, the claim is that of the corporation and the right to a jury trial is to be judged as though the corporation were suing. This decision gives effect to *Fleitmann* v. *Welsbach Street Lighting Co.*, 240 U.S. 27 (1916), and *Fanchon & Marco, Inc.* v. *Paramount Pictures, Inc.*, 202 F. 2d 731 (2d Cir. 1953), in which this result was reached in antitrust treble damage actions. I see no reason why this rule should be peculiar to antitrust litigation. I will follow it here.

As to the second question, the allegations of the complaint are controlling. The complaint uses a number of harsh words. It charges that defendants have been guilty of "gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence and a reckless disregard of their fiduciary duties." The prayer is for a judgment "requiring the defendants jointly and severally to account for and pay to the Corporation for their profits and gains and its losses."

The fact that plaintiffs seek an accounting, a word which smacks of equity, is not determinative.

Dairy Queen, Inc. v. Wood, 369 U.S. 469 (1962)

Plaintiffs are seeking a money judgment. They ask that defendants "pay" to the corporation defendants' gains and the corporation's loss. The issues are not so complicated

as to make it impracticable for a jury to ascertain the amount, if any, to which plaintiffs may be entitled.

It is true that the complaint employs equitable language in alleging that defendant directors have abused their trust and have disregarded their fiduciary duties. But the alleged facts which underlie these conclusions are simply that defendants have caused the corporation to pay out money which the corporation should not have paid, and that in consequence, the corporation is entitled to judgment for those moneys. This diversion of funds is alleged to be a conversion by defendants of the corporate assets. Whatever the law may formerly have been, I am persuaded that recent decisions of the Supreme Court, which have gone far in protecting the right to a jury trial under the Seventh Amendment, require the conclusion that this complaint states on behalf of the corporation a claim which is fundamentally legal rather than equitable.

Dairy Queen, Inc. v. *Wood, supra;*
Beacon Theatres, Inc. v. *Westover*, 359 U.S. 500 (1959);
See also DePinto v. *Provident Security Life Insurance Company, supra.*

Defendants' motion is denied.

So ordered.

Dated: November 3, 1967

EDWARD C. McLEAN
U.S.D.J.

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 6—September Term, 1968

(Argued September 5, 1968 Decided November 1, 1968.)

Docket No. 32118

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,

Plaintiffs-Appellees,

—v.—

ROBERT A. BERNHARD, *et al.*,

Defendants-Appellants.

Before:

LUMBARD, *Chief Judge,*
SMITH and ANDERSON, *Circuit Judges.*

Appeal from an order entered December 6, 1967 by McLean, *J.*, United States District Court for the Southern District of New York, denying defendants' motion to strike plaintiffs' demand for a jury trial, on the ground that the Seventh Amendment to the United States Constitution extends the right to a jury trial to stockholders' derivative actions.

Order reversed and cause remanded.

ROSENTHAL & GURKIN, New York, N. Y. (Pomerantz Levy Haudek & Block, New York, N. Y., Abraham L. Pomerantz and Richard M. Meyer, on the brief), *for Plaintiffs-Appellees.*

SULLIVAN & CROMWELL, New York, N. Y. (Marvin Schwartz and Cornelius B. Prior, Jr., on the brief), *for Defendants-Appellants, Clark, Francis, Kircher, Puckett, Reavis, Thornton and Wilde.*

SIMPSON THACHER & BARTLETT, New York, N. Y. (William J. Manning and Lawrence M. Mc Kenna, on the brief), *for Defendants-Appellants, Robert A. Bernhard, et al.*

WALSH & FRISCH, New York, N. Y. (E. Roger Frisch, on the brief), *for Defendant-Appellant, The Lehman Corporation.*

LUMBARD, *Chief Judge*:

This appeal, taken by permission, questions a district court ruling which would allow a jury trial of a stockholders' derivative action. The defendants in this diversity action appeal from a Southern District order entered November 6, 1967 denying their motion to strike plaintiffs' demand for a jury trial. On December 6, 1967, Judge McLean granted defendants' motion to resettle his order, finding that it involved "a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from this order may

materially advance the ultimate termination of this litigation." As there is a difference of views in the district court on this question, see *Richland* v. *Crandall*, 259 F. Supp. 274 (S. D. N. Y. 1966), we thereafter permitted an interlocutory appeal to be taken pursuant to 28 U. S. C. §1292(b).

We hold that the right to a jury trial guaranteed by the Seventh Amendment to the United States Constitution does not extend to stockholders' derivative actions. Accordingly, we reverse the order of the district court.

This derivative action was brought under the Investment Company Act of 1940, 15 U. S. C. §§80a-1, et seq. Named as defendants are the Lehman Corporation, the investment company for whose benefit the suit is brought, various directors and officers of the corporation, and various partners of Lehman Brothers, an investment banking firm which acts as the investment advisor and principal broker for the corporation. Plaintiffs, stockholders of the Lehman Corporation, pray for a judgment requiring defendants to account for, and pay to the corporation, their profits and gains and its losses resulting from illegal and excessive brokerage commissions paid to Lehman Brothers. These commissions fall in three categories:

> 1) Commissions paid for carrying out transactions for the corporation on the New York Stock Exchange, despite the fact that these transactions could have been executed on the so-called "Third Market" at favorable net prices without the payment of any commissions, or executed other than on a national securities exchange with the payment of substantially smaller commissions than were paid to Lehman Brothers.

2) Commissions paid in connection with over-the-counter transactions in unlisted stocks, despite the fact that the corporation could have conducted these transactions directly with "market makers" and thus avoided paying any commissions.

3) "Reciprocal brokerage commissions" paid by the corporation for allocation to the brokers who provide investment advice to Lehman Brothers, which commissions constitute excessive compensation to Lehman Brothers under its investment advisory contract with the corporation.

The complaint further alleges that more than half of the corporation's directors are affiliated with Lehman Brothers, in violation of §10(b)(1) of the Investment Company Act, 15 U. S. C. §80a-10(b)(1). The payments are alleged to constitute "an unlawful and willful conversion" by defendant partners of Lehman Brothers of the corporation's assets, and "gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence and a reckless disregard of their fiduciary duties" by the defendant officers, directors and brokers of the corporation.

The Seventh Amendment provides:

> In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

Judge McLean held that the question of whether the Seventh Amendment required this action to be tried before a jury, upon plaintiffs' demand, depended upon the nature of the corporate claim asserted derivatively by the stockholders; the Seventh Amendment was to be applied as if the corporation itself were suing. He further found that the corporate claim in this action was legal, rather than equitable, in character, being in essence a demand for a money judgment to recover the funds of the corporation converted by defendants. Thus the right to a jury trial attached to this derivative action.

Our disagreement with the court below stems from the teaching of history that the stockholder's derivative action has always been regarded as exclusively a creature of equity to which the right to a jury trial does not apply. The one previous dissent from this view, *DePinto* v. *Provident Security Life Ins. Co.*, 323 F. 2d 826 (9th Cir. 1963), *cert. denied* 376 U. S. 950 (1964), we do not find persuasive. Because of our view of the jury trial issue we have no occasion to address the question of whether the underlying corporate claim is legal or equitable in character.

In determining whether the constitutional right to a jury trial applies to a given action, the basic inquiry to be made is an historical one: At the time the Seventh Amendment was adopted was the action recognized as a "suit at Common law," as to which the right to a jury trial was to be "preserved." *Baltimore & C. Line* v. *Redman*, 295 U. S. 654, 657 (1935). Despite the merger of law and equity accomplished by the Federal Rules of Civil Procedure the right to a jury trial still applies only to actions which historically could have been brought at law. Rule 38(a), Fed.

R. Civ. P., preserves the right to a jury trial "as declared by the Seventh Amendment to the Constitution . . ." While the Supreme Court seems to have modified this historical test somewhat to take account of the procedural reforms effectuated by the Federal Rules, *Beacon Theatres* v. *Westover*, 359 U. S. 500, 508-11 (1959), for reasons stated below we do not believe that this modification affects the outcome of this case.

The authorities are agreed that the stockholders' derivative action did not evolve until well after the adoption of the Seventh Amendment in 1791. *See*, e.g., Prunty, *The Shareholders' Derivative Suit: Notes on Its Derivation*, 32 N. Y. U. L. Rev. 980, 981, 986 (1957). This fact does not, as defendants suggest, foreclose the possibility that derivative actions fall within the scope of the Seventh Amendment. In instances where either Congress or the courts have evolved a new remedy subsequent to the adoption of the Amendment it is to be analogized to its nearest historical counterpart, at law or equity, for the purposes of determining whether a right to jury trial exists. *See* 5 Moore, Federal Practice ¶38.11[7], at 125 (2nd ed. 1968); James, *Right to a Jury Trial in Civil Actions*, 72 Yale L. J. 654, 655 (1963). No tortuous process of historical analogy is required in this case, however, for it is clear that the derivative action was an invention of equity.

At law stockholders could not bring a suit in the corporation's name for the vindication of a corporate right because, apparently, such legal standing was regarded as incompatible with the limited liability for the corporation's debts enjoyed at law by the stockholders. Note, *The Right to a Jury Trial in a Stockholder's Derivative Action*, 74

Yale L. J. 725, 729 (1965). Beginning early in the Nineteenth Century equity began to recognize the derivative action, initially in order to provide a remedy against alleged wrongdoers to the corporation who also controlled its management and consequently refused to allow a suit by the corporation against themselves. *Taylor* v. *Miami Exporting Co.*, 5 Ohio 162 (1831); *Robinson* v. *Smith*, 3 Paige Ch. *222, *233 (N. Y. 1832) (dictum); *see* generally *Koster* v. *Lumbermens Mut. Co.*, 330 U. S. 518, 522 (1947). The remedy soon was extended to instances where the stockholders were seeking to enforce a corporate right against an outsider. *Dodge* v. *Woolsey*, 59 U. S. (18 How.) 331, 341-44 (1855); cf. *Forbes* v. *Whitlock*, 3 Ed. Ch. 446 (N. Y. 1841).

From these early suits to the present day the equitable nature of the derivative action has not been disputed. See *Dodge* v. *Woolsey*, 59 U. S. (18 How.) 331, 341 (1855); *Cohen* v. *Beneficial Loan Corp.*, 337 U. S. 541, 548 (1949). Likewise, with the sole exception of the *DePinto* decision, *supra*, there has been no significant dissent from the conclusion that the equitable nature of the action excludes it from the purview of the Seventh Amendment's jury trial guarantee. E.g., *Richland* v. *Crandall*, 259 F. Supp. 274 (S. D. N. Y. 1966); 5 Moore, Federal Practice ¶38.38[4], at 305-06 (2nd ed. 1968); 2 Hornstein, Corporation Law and Practice, ¶730 (1959); 13 Fletcher, Private Corporations, §5931 (Rev. ed. 1961); Note, *The Right to a Jury Trial in a Stockholder's Derivative Action*, 74 Yale L. J. 725, 732 n. 35 (1965) (citations to state court decisions under constitutional provisions similar to Seventh Amendment).

The court below, despite this impressive authority against the right to jury trial in derivative actions, reached a contrary result. It pointed out that a derivative action is composed of two distinct claims: 1) the stockholders' claim against the corporation for its refusal to sue in its own name, and 2) the underlying claim put forward for the corporation's benefit. The court held that while it must rule on the equitable issue of the stockholders' right to sue in the corporation's stead, there is no reason to refuse a demand for a jury trial on the underlying corporate claim if it is legal in character.

Other than the *DePinto* case the only supporting authorities cited by the court for its conclusion are *Fleitman* v. *Welsbach Street Lighting Co.*, 240 U. S. 27 (1916), and *Fanchon & Marco, Inc.* v. *Paramount Pictures, Inc.*, 202 F. 2d 731 (2d Cir. 1953). Both suits concerned derivative suits seeking treble damages under the Sherman Act. In the brief *Fleitman* opinion by Justice Holmes the court held that a derivative action would not lie, and for a reason which provides analogous support for defendants in this case. Justice Holmes pointed out that there could be no right to a jury trial in the equitable derivative action. Since he read the Sherman Act as requiring that treble damage actions be tried before a jury the Justice concluded that the derivative action could not be maintained.

Judge Clark's opinion in *Fanchon & Marco* did hint, entirely as dictum, that a jury trial could be demanded by a stockholder suing derivatively for treble damages. Since the jury trial issue does not appear to have been directly presented to the court we do not regard *Fanchon & Marco* as persuasive authority on this point. Moreover, whatever

was said in that opinion relates only to the *statutory* right to jury trial created by the Sherman Act, a fact made clear by the court's reliance on *Fleitman*. We deal here with the constitutional right to a jury trial. The accommodation suggested in *Fanchon & Marco* between the Sherman Act's requirement of a jury trial and the equitable nature of derivative actions is not relevant to our case, where no statutory right exists.[1]

On appeal plaintiffs urge the relevance of two Supreme Court cases construing the Seventh Amendment, *Beacon Theatres, Inc.* v. *Westover*, 359 U. S. 500 (1959), and *Dairy Queen, Inc.* v. *Wood*, 369 U. S. 469 (1962). Neither case is in point.

In *Beacon Theatres* the plaintiff, a theatre operator, alleged that he was being damaged by defendant's threat to file a treble damage action under the antitrust laws challenging the legality of plaintiff's exclusive "first run" contracts with motion picture distributors. Plaintiff sought an injunction against the threatened suit and a declaration that the contracts did not violate the antitrust laws. Defendant counterclaimed for treble damages on the ground that the contracts were illegal.

The Supreme Court noted that both the plaintiff's suit and the defendant's counterclaim revolved around the exact same issue: Were plaintiff's contracts in violation of the antitrust laws? The question, then, was whether plaintiff, by bringing a declaratory action for injunctive relief before

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[1] Plaintiffs on appeal make a fleeting argument in their brief that the Investment Company Act should be read as creating a statutory right to a jury trial. Brief for plaintiffs, p. 5. This question was not raised in the court below; and the record before us is not sufficient to enable this court to address the issue.

defendant could bring his law action for treble damages, thereby could deprive defendant of his right to have the antitrust issue tried before a jury. It was no surprise that the court said no; the common issue on which both the equitable and legal relief depended must be tried on the law side in order that the right to jury trial not be defeated altogether. *See* 359 U. S. at 504; James, *Right to a Jury Trial in Civil Actions,* 72 Yale L. J. 655, 687-90 (1963).

We have no such "race to the courthouse" situation in our case. Plaintiffs have lost no right to a jury trial they would have possessed had this issue been litigated at law; were it not for equity, plaintiffs would not be in court at all. In *Beacon Theatres* equity was invoked only to anticipate and defeat the assertion of a legal claim. Here equity grants to plaintiffs their capacity to sue, not merely an alternative form of relief. It is from the fountainhead of equity that this entire litigation flows, and we see no justification for artificially dividing the suit into two parts for the purposes of applying the Seventh Amendment. *See,* Note, *The Right to a Jury Trial in a Stockholder's Derivative Action,* 74 Yale L. J. 725, 729-32 (1965).

In *Dairy Queen, Inc.* v. *Wood,* 369 U. S. 469 (1962), the plaintiff sued for trademark infringement and sought both an accounting, which the Court viewed as a claim essentially legal in character, and an injunction. Once again the Court was confronted by two claims for relief which turned on the same issue. If the claim for an injunction were tried first the principle of collateral estoppel would bar a second trial, before a jury, on the legal claim for damages. In these circumstances the court held that the right to a jury trial could not be defeated by labeling the

legal claim "incidental" to the equitable claim and trying the latter claim first; rather the jury trial on the issue of damages must be given priority.

Unlike *Dairy Queen,* the complaint in this case does not merely join two claims which could have been presented in separate suits. Rather, the assertion of any "legal" claim on behalf of the corporation is totally dependent upon plaintiffs' successfully establishing their capacity to sue at equity. Thus in applying the Seventh Amendment the two portions of the complaint cannot be regarded as separable and divisible. Cf. *Robine* v. *Ryan,* 310 F. 2d 797, 798 (2d Cir. 1962).

The Supreme Court in *Beacon Theatres* and *Dairy Queen* did modify the historical test for applying the Seventh Amendment in one respect. The court noted that a prerequisite for equity jurisdiction has always been that no adequate remedy at law exists. One application of this rule concerned the "clean-up" power of an equity court; for the convenience of the parties, and to protect rights which might be jeopardized through the delay which would be caused by requiring an additional suit at law, equity courts whose jurisdiction had been properly invoked by an equitable claim would also dispose of related legal issues. This procedure, which operated to deny a jury trial of those related legal issues, is no longer justified in light of the liberal joinder provisions of the Federal Rules of Civil Procedure. Under the Rules a judge can have the legal issues tried first before a jury, and then immediately decide the equitable issues himself. There is no danger of jeopardizing rights through delay. Thus the court has held that the scope of equitable jurisdiction has declined

pro tanto as the adequacy of legal relief has increased through the procedural reforms of the Federal Rules. *Beacon Theatres, Inc.* v. *Westover*, 359 U. S. 500, 509 (1959).

This modification of the Seventh Amendment standard does not affect the determination of this case. Equity courts have not exercised jurisdiction over the underlying corporate claims in derivative suits pursuant to their clean-up power, but rather because law has never recognized suits brought by stockholders for their corporation's benefit. The derivative action analytically may be composed of two parts, but before the courts it has always been treated as one, unitary action brought at equity. *See* Note, *The Right to a Jury Trial in a Stockholder's Derivative Action*, 74 Yale L. J. 725, 729-32 (1965).

It is argued that refusing to extend the right to jury trial to derivative actions will cause anomalous results in cases where it is the defendant who demands a jury trial. The plaintiffs point out that while such a defendant would be entitled to a jury trial if the corporation itself brings a legal claim against him, he is, in plaintiffs' words, "cheated out" of his jury if the action is brought derivatively by the stockholders. But if a corporation and its stockholders conspire to have a claim brought derivatively, rather than by the corporation, for the purpose of depriving defendant of a jury trial, his rights can be protected by a remedy less severe than a far-reaching extension of the Seventh Amendment. The refusal of a corporation to sue in its own name in order to avoid a jury trial would violate the spirit of Rule 23.1, Fed. R. Civ. P., and there would be no basis for invoking the jurisdiction of equity to hear a derivative action. Of course no danger of collusion is present in

this case since all defendants are resisting plaintiffs' attempt to secure a jury trial.

As for the anomaly plaintiffs claim to perceive arising from the denial of a jury trial, it has existed since the very origin of the derivative action. We are aware of no great agitation among potential litigants or the bar concerning the traditional rule against jury trials in derivative actions.

It may well be that juries, perhaps with the aid of a master, see *Dairy Queen, Inc.* v. *Wood*, 369 U. S. 469, 478 (1963), are perfectly competent to try derivative actions, although we entertain some doubt on this point because of the exceedingly complex nature of many of these actions. But the Seventh Amendment does not ask that we assess the suitability of a given type of litigation for jury trial. In addition to invoking a judicially unmanageable standard, *see* James, *Right to a Jury Trial in Civil Actions*, 72 Yale L. J. 655, 690-91 (1963), such an inquiry would violate the Amendment's instruction that we "preserve," i.e., neither expand nor contract, the constitutional right to a jury trial. After all, there is little practical reason why a jury could not try many suits for injunctions.

The historical test established by the Seventh Amendment may be artificial from a functional point of view. But it satisfies the basic purpose of its drafters of safeguarding from erosion the right to jury trials which existed at the time of its adoption. Applying this test in this case we hold that a stockholders' derivative action is not a "suit at common law" to which the right to jury trial extends.

SMITH, *Circuit Judge* (dissenting):

I dissent. I would affirm the order denying the motion to strike the demand for jury trial. The underlying claim is essentially "a suit at common law," an action for a money judgment for unlawful conversion, breach of fiduciary duty, fraud and gross negligence. It would have been apt for jury consideration had the corporation itself sued. The issues are not so complex as to be beyond the competence of a trial jury. Cf. *Dairy Queen* v. *Wood*, 369 U. S. 469, 479 (1962). The fact that historically it was necessary for the shareholder to resort to equity in order to step into the corporation's shoes (*Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U. S. 541, 548 (1949)), should no longer bar jury trial of the corporate claim. The reason for the denial of jury is eliminated through the provision by the federal rules of one civil action in which the issues of the right of the shareholder to sue and of violation of fiduciary duty causing damage to the corporation may "be tried side by side or otherwise as may be convenient; that one may go to the jury while the other does not causes no difficulty," *Fanchon & Marco* v. *Paramount Pictures*, 202 F. 2d 731, 735 (2d Cir. 1953). I would agree with the result reached by the Ninth Circuit in *DePinto* v. *Provident Security Life Ins. Co.*, 323 F. 2d 826 (9 Cir. 1963), cert. denied 376 U. S. 950, rehearing denied 383 U. S. 973.

Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the first day of November one thousand nine hundred and sixty-eight.

Present:

HON. J. EDWARD LUMBARD,
Chief Judge,

" J. JOSEPH SMITH,
" ROBERT P. ANDERSON,
Circuit Judges.

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,

Plaintiffs-Appellees,

v.

ROBERT A. BERNHARD, et. al.,

Defendants-Appellants.

Judgment of the Court of Appeals

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and that the action be and it hereby is remanded for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellees.

A true copy.

A. Daniel Fusaro

Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM 1968

No. 42

Office-Supreme Court,
FILED
FEB 26 1969
JOHN F. DAVIS, CLERK

HOWARD BOSS and BERNARD BOSS, as Trustees for LENA ROSENBAUM,

Petitioners,

—against—

ROBERT A. BERNHARD, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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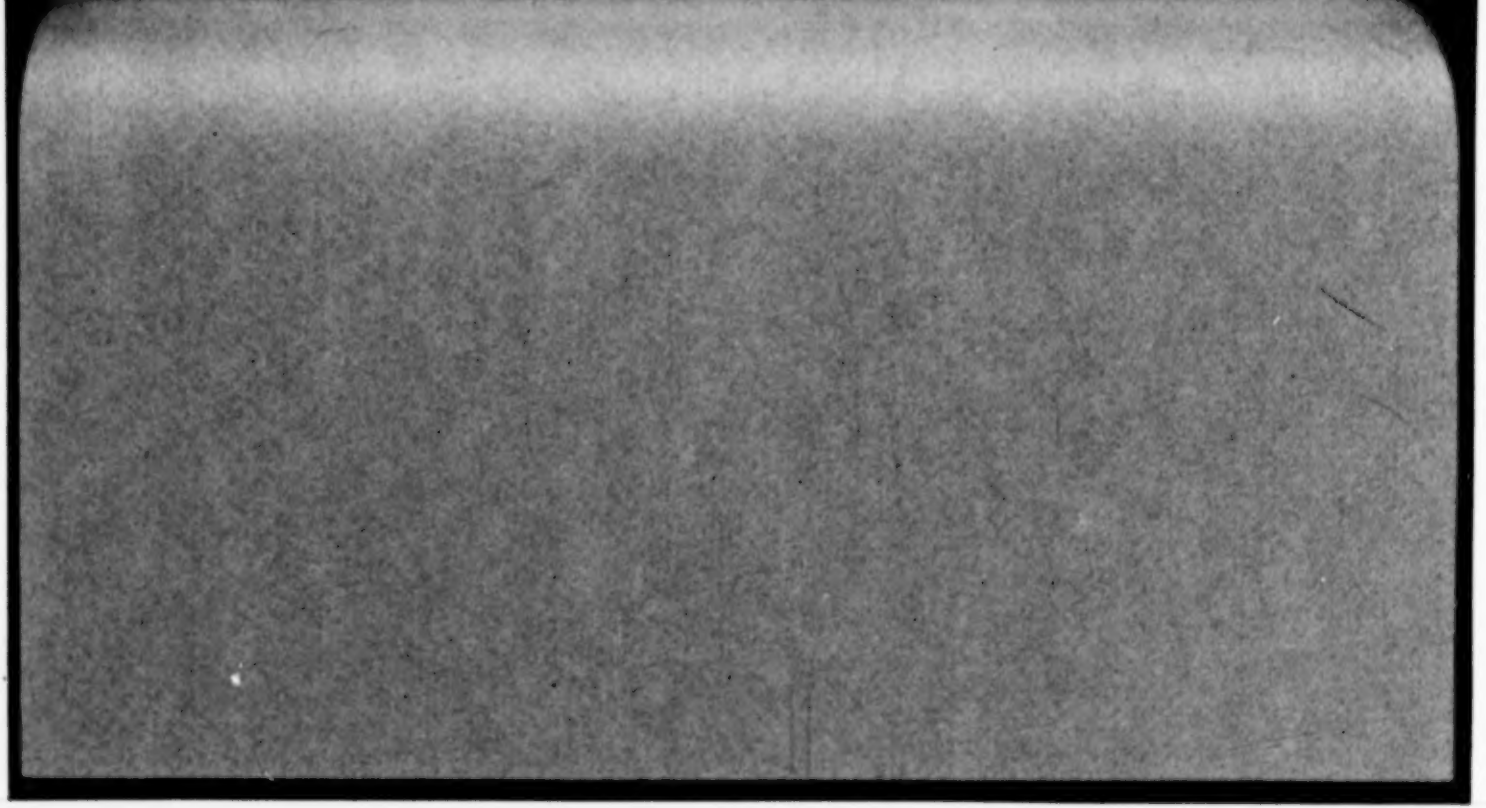
February 25, 1969



IN THE

Supreme Court of the United States

October Term 1968

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,
Petitioners,
—against—
ROBERT A. BERNHARD, *et al.*,
Respondents.

No. 992

RESPONDENTS' BRIEF IN OPPOSITION

The Question Presented

Irrespective of the nature of the claim asserted on behalf of the corporation, does the plaintiff in a stockholder's derivative suit have a personal constitutional right to trial by jury of the claim he asserts on behalf of the corporation?

Reasons for Denial of the Writ

I.

Not every conflict among the circuits requires resolution by this Court and this is just such a case. The decision which petitioners challenge was clearly correct in its statement and application of the controlling constitutional standard: Was there a right to jury trial in a stockholder's derivative suit at common law at the time of the adoption of the Seventh Amendment in 1791 or, indeed, at any subsequent time? *Parsons* v. *Bedford,* 28 U.S. (3 Pet.) 433

(1830); *Dimick* v. *Schiedt*, 293 U.S. 474, 476 (1935); *Baltimore & C. Line* v. *Redman*, 295 U.S. 654, 660 (1935).

A litigant's right to trial by jury under the Seventh Amendment is thus to be determined by history and by history alone. If there was no right to trial by jury in such a case at common law, there is no right to jury trial preserved by the Seventh Amendment. The petition acknowledges by its complete silence on the point that the stockholder's derivative suit is and always has been a creature of equity. It follows that there is no jury right which the Seventh Amendment could preserve. *Koster* v. *Lumberman's Mutual Co.*, 330 U.S. 518, 522 (1946); *Attorney-General* v. *The Governors of the Foundling Hospital*, 2 Ves. Jun. 42 (1793); *Attorney-General* v. *Utica Insurance Co.*, 2 Johns. Ch. 371 (N.Y. 1817); *Brinckerhoff* v. *Bostwick*, 105 N.Y. 567 (1887); *Bookbinder* v. *Chase National Bank*, 244 App. Div. 650 (1st Dep't 1935); *Rebstock* v. *Lutz*, 158 A.2d 487 (Del. 1960); *Rosenthal* v. *Burry Biscuit Corp.*, 60 A.2d 106 (Del. Ch. 1948); 4 *Pomeroy, Equity Jurisprudence*, § 1095 (5th ed. 1941); Prunty, *The Shareholders' Derivative Suit: Notes On Its Derivation*, 32 N.Y.U.L. Rev. 980 (1957); Note, *The Right to a Jury Trial in a Stockholder's Derivative Action*, 74 Yale L.J. 725 (1965).*

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* With the single exception of *DePinto* v. *Provident Security Life Ins. Co.*, 323 F.2d 826 (9th Cir. 1963) *cert. denied*, 376 U.S. 950 (1964), *reh. denied* 383 U.S. 973 (1966), our research does not indicate that any stockholder's derivative suit in this country or in England has ever been tried to a jury. Certainly no such suit has ever been tried to a jury in the Southern District of New York, which probably entertains a far greater number of such suits than any other district. Contrary to petitioners' insinuation (Pet., p. 10fn), no derivative claim was tried to a jury in *Richland* v. *Crandall*, 259 F. Supp. 274 (S.D.N.Y. 1966), where after the court determined that derivative claims were not triable to a jury, representative class claims were tried to a jury and derivative claims were later determined by the court.

Moreover, prior to the merger of law and equity effected in 1938 by the Federal Rules of Civil Procedure, stockholders' derivative suits could be brought only on the equity side of the federal courts. It was apparently not until 1855 that the first stockholder's derivative suit came to this Court and on that occasion this Court stressed that the "stockholder's bill" was an invention of equity for "prosecution of injuries for which common-law courts were inadequate" *Dodge v. Woolsey*, 59 U.S. (18 How.) 331, 341 (1855). The equitable remedy which this Court approved in *Dodge v. Woolsey* soon became the subject of abuse as corporations procured stockholders to bring derivative suits to take advantage of diversity jurisdiction that might not otherwise be available. In *Hawes v. Oakland*, 104 U.S. 450 (1881), the Court attempted to curb such abuses by holding that a stockholder could not sue on behalf of the corporation unless he held his stock at the time of the wrong complained of and unless the corporation refused, despite honest efforts by the stockholder, to bring the action on its own behalf. The precaution devised in *Hawes* v. *Oakland* was almost simultaneously promulgated as Equity Rule 94 (104 U.S. ix). That rule, with only minor revision, became Equity Rule 27 in 1913 (226 U.S. 629, 656) and later the original Rule 23 (now Rule 23.1) of the Federal Rules of Civil Procedure.

In providing in Rule 38 of the Federal Rules of Civil Procedure that the right to trial by jury "shall be *preserved* to the parties inviolate" [emphasis added], certainly this Court did not intend to confer jury rights in a type of case which previously could be brought only in equity and which was specifically provided for in the Equity Rules.

II.

Ignoring completely the controlling historical test, petitioners rest upon an ingenious twist of this Court's admonition in *Dairy Queen, Inc.* v. *Wood*, 369 U.S. 469, 470-472 (1962) that the merger of law and equity was not intended to deprive litigants of their constitutional right to trial by jury of legal issues. Petitioners' theory is that the stockholder asserts two separate claims in a derivative suit—an equitable claim against the corporation for failure to bring suit against the alleged wrongdoers and a legal claim on behalf of the corporation —, that it was only equity's jurisdiction over the first claim which gave it jurisdiction over the second and that now, with the merger of law and equity in the federal courts, both can be tried together, one to a jury and the other to the court. The flaw in petitioners' theory is that the two elements of a derivative suit are not and never were separate or divisible; the stockholder plaintiff cannot recover unless he prevails on both. Neither as a matter of historical development or common sense could it be said that the claim asserted on behalf of the corporation is "incidental" to the equitable claim against the corporation for its refusal to sue.

Moreover, as this Court observed in *Dairy Queen, Id.* at 470-471, a federal court of equity, prior to the promulgation of the Federal Rules of Civil Procedure in 1938, could not even take jurisdiction of a suit in which legal and equitable claims were joined. *Scott* v. *Neely*, 140 U.S. 106 (1891); *Cates v. Allen*, 149 U.S. 451 (1893). In consistently recognizing between 1855 and 1938 that stockholders' derivative suits were maintainable in the federal equity courts, this Court necessarily rejected the notion that for the purpose of determining rights to jury trial, the derivative suit consisted of separable legal and equitable claims.

III.

The "Question Presented" by the petition assumes incorrectly that the claims which petitioners assert on behalf of the corporation are legal in nature, so that if asserted by the corporation, both the corporation and the defendants could demand a jury. Apart from the fact that it is only the plaintiff shareholders here who seek a jury, the Court of Appeals did not reach the question whether the claims asserted by petitioners on behalf of the corporation were legal in nature.

Petitioners' second amended complaint belies on its face the petition's characterization of petitioners' claims as sounding in "negligence" (Pet., p. 11). Instead, the second amended complaint clearly and unequivocably accuses the defendants of fraud and overreaching, of wilful and deliberate breaches of duties which are alleged to be "fiduciary" (pars. 15, 17, 21, 22). The word "negligence" appears only once in a single paragraph of the second amended complaint as part of the phrase "gross negligence" and even that phrase appears only as one of a string of epithets which are hardly consistent with mere negligence.*

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* Paragraph 21 of the second amended complaint reads as follows:

"21. The payment of these brokerage commissions to Lehman Brothers and others has constituted and continues to constitute an unlawful and willful conversion by Lehman Brothers and the individual defendants of the monies, funds, property and assets of the Corporation to the use of Lehman Brothers in violation of Sec. 37 of the Act; and gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence and a reckless disregard of their fiduciary duties by the Corporation's officers, directors and brokers in violation of the duties which the Act (Secs. 1(b)(2), 10, 17(h) and (i) and 36) expressly and by necessary implication imposes upon officers, directors and brokers of investment companies."

There would be no right to trial by jury even if petitioners' epithets were hurled by the corporation, for traditionally it was only in equity rather than through the writs of the common law that redress was available for misuse of corporate office. *Robinson* v. *Smith,* 3 Paige Ch. 221 (N.Y. 1832); *Attorney-General* v. *The Governors of the Foundling Hospital,* 2 Ves. Jun. 42 (1793); and *Adley* v. *Whitstable Co.,* 17 Ves. Jun. 315 (1810).

The amended complaint alleges that over a period of five years, Lehman Brothers received approximately $2,000,000 in brokerage commissions from the corporation (A. 19). Manifestly, there were in those five years many thousands of separate portfolio transactions aggregating scores of millions of dollars. Alleging that some of these thousands of transactions were improperly executed at excessive cost to the corporation, petitioners seek an accounting for defendants' "profits".

Since petitioners allege one species of breach of trust in connection with transactions in listed securities and quite another in connection with transactions in unlisted securities, the task confronting the trier of fact will be to examine the two types of transactions separately. The trier of fact may be required to cull from many thousands of transactions in listed securities those which petitioners claim could have been executed off the Exchange in the so-called "third market" and to determine with respect to each such transaction whether the "third market" offered advantages to the corporation which the defendants unlawfully forsook. With respect to over-the-counter transactions, the trier of fact may be required to determine with respect to each whether Lehman Brothers was unnecessarily "interposed", and if so, whether the cor-

poration was damaged and in what amount. And if any transactions, whether in listed or in unlisted securities, are found to have been unlawful, the trier of fact may be required to determine as to each the extent to which defendants profited unlawfully. Thus, each of many thousands of transactions may require a precise and obviously difficult measurement of claimed disadvantage to the corporation.

It would be a perversion of history to suggest that the dissatisfaction with the Constitution as first presented to the states for adoption and which gave rise to the first ten amendments was rooted in any conviction that cases of such complexity should be tried by veniremen of the community. The contemporaneous literature demonstrates to the contrary that the Seventh Amendment was intended to preserve the traditional role of the Chancellor in deciding—without the intervention of a jury—those "nice and intricate" issues which "are incompatible with the genius of trials by jury". As Hamilton pointed out in *The Federalist* while the first ten amendments were being considered by the states:

> ". . . the circumstances that constitute cases proper for courts of equity, are in many instances so nice and intricate, that they are incompatible with the genius of trials by jury. They require often such long and critical investigation, as would be impracticable to men called occasionally from their occupations, and obliged to decide before they were permitted to return to them. The simplicity and expedition which form the distinguishing characters of this mode of trial require, that the matter to be decided should be reduced to some single and obvious point; while the litigations usually in chancery, frequently comprehend a long train of minute and independent particulars." *The Federalist*, op. cit., p. 621.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM 1968

NO. ~~692~~ 42

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,

Petitioners,

—v.—

ROBERT A. BERNHARD, *et al.*,

Respondents,

and

PAUL L. DAVIES, *et al.*,

Defendants.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONERS

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IN THE

Supreme Court of the United States

October Term 1968

No. 992

HOWARD ROSS AND BERNARD ROSS, AS TRUSTEES FOR LENA ROSENBAUM,

Petitioners,

—v.—

ROBERT A. BERNHARD, *et al.*,

Respondents.

and

PAUL L. DAVIES, *et al.*,

Defendants.

BRIEF FOR PETITIONERS

Opinions Below

The opinion of the Court of Appeals for the Second Circuit is reported at 403 F.2d 909. The opinion of the District Court for the Southern District of New York is reported at 275 F. Supp. 569.

Jurisdiction

The judgment of the Court of Appeals herein was entered on November 1, 1968 (A. 2). The petition for a writ of certiorari was filed on January 29, 1969 and was granted March 24, 1969. This Court's jurisdiction is based

on 28 USC § 1254(1). The jurisdiction of the Court of Appeals was based on 28 USC § 1292(b), that Court having accepted a certification from the District Court. The District Court's jurisdiction was based upon the Investment Company Act of 1940, 15 USC §§ 80a-1, et seq.

Constitutional Provisions and Statutes

Seventh Amendment to the Constitution:

> "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law."

Section 44 of the Investment Company Act of 1940, 15 USC § 80a-43:

> "Sec. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder . . ."

Question Presented

When a corporate action to recover money entitles all parties to a jury trial, is the jury right lost where the corporation is compelled to seek relief at the instance of a stockholder in a derivative action?

Statement of the Case

This is an action brought by stockholders of The Lehman Corporation in its right and on its behalf. It is brought under the Investment Company Act of 1940, 15 USC §§ 80a-1, et seq. The amended complaint alleges that the Corporation, under the control of its broker, Lehman Brothers, has paid illegal and unnecessary brokerage commissions to Lehman Brothers (A. 22-26). The plaintiffs made timely demand for a jury trial (A. 20). Pre-trial discovery was completed, plaintiffs filed a note of issue and the action was placed upon the trial calendar (A. 31). Defendants then moved to strike plaintiffs' demand for jury trial and to transfer the case to the non-jury calendar (A. 28). The District Court denied defendants' motion, but certified the question to the Court of Appeals for the Second Circuit (A. 51-52), which accepted the certification (A. 57). The Second Circuit, in a two-to-one opinion, reversed the District Court. 403 F.2d 909.

ARGUMENT

I.

Plaintiffs are constitutionally entitled to a jury trial in a derivative stockholders action if a right to jury trial would exist were the underlying cause of action brought directly by the corporation.

The right to jury trial in civil actions, guaranteed by the Seventh Amendment, has been jealously safeguarded by this Court.

> ". . . 'Maintenance of the jury as a fact finding body is of such importance and occupies so firm a

> place in our history and jurisprudence that any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care.' " *Beacon Theatres, Inc.* v. *Westover,* 359 U.S. 500, 501 (1959).

In so holding, the Court re-affirmed the importance of the institution of the civil jury as a democratic check upon the power of the judiciary. See *Parsons* v. *Bedford,* 28 U.S. (3 Pet.) 433, 446 (1830); Waterman, *Thomas Jefferson and Blackstone's Commentaries,* 27 Ill. L. Rev. 629, 643 (1933); Hogan, *Joseph Story on Juries,* 37 Ore. L. Rev. 234, 235 (1958); 3 *Elliott's Debates,* 324, 554 (1836).

Mr. Justice Holmes explained how the jury system's guarantee of popular participation in the judicial process operates:

> "Indeed one reason why I believe in our practice of leaving questions of negligence to them [the jury] is what is precisely one of their gravest defects from the point of view of their theoretical function: that they will introduce into their verdict a certain amount —a very large amount, so far as I have observed—of popular prejudice, and thus keep the administration of the law in accord with the wishes and feelings of the community." (Holmes, *Law In Science and Science in Law,* 12 Harv. L. Rev. 443, 459-60 (1899); interpolation added.)

In our "People's Capitalism" embracing 27 million stockholders of public corporations the applicability of the conception of popular control to the derivative action is especially compelling.

The Seventh Amendment preserves the right of trial by jury "In Suits at common law"; not to suits in equity. The Court of Appeals below held that a stockholder's

derivative action is "a creature of equity" to which the right of a jury trial does not apply. 403 F. 2d at 911.

That the derivative stockholder's action is an invention of equity may be conceded. However, the proposition states only a half truth. A derivative action is constituted of two parts. The first part concerns the shareholder's right to maintain the action on behalf of the corporation. This is a procedural mechanism of equity. The second part is the underlying claim of the corporation asserted in the action. This claim may be either legal or equitable depending upon its nature. *Koster* v. *Lumbermens Mutual Cas. Co.*, 330 U.S. 518, 522-23 (1947); *Meyer* v. *Fleming*, 327 U.S. 161, 168 (1946).

Prior to the union of law and equity, an equity court, once having taken jurisdiction, would proceed to final adjudication of all issues, legal and equitable, in the suit. There was no practical alternative. Trying one half of the case (the right of the stockholders to hail the corporation into Court) in equity, while sending the other half (the corporation's claims against defendants) to another judge sitting on the law side, had little appeal against considerations of litigative efficiency.

The adoption of the Federal Rules of Civil Procedure in 1938 worked an historical change by merging law and equity into a single unified system. The artificial restraints of the old system were eliminated. It now became possible for a litigation to be tried before a single judge sitting at once as a law court trying the legal issues with a jury if demanded, and an equity court trying the equity issues.

The Court of Appeals below reached its result by utilizing pre-merger concepts: It noted that a derivative action,

under the pre-unified system, would have had to be instituted in equity and an equity court would have decided the entire case without reference to a jury. Therefore, it held, no right to trial by jury is ever present in a stockholder's derivative action, even though the underlying corporate claim be legal.

This Court, however, rejected just such a test in *Beacon Theatres, Inc.* v. *Westover,* 359 U.S. 500 (1959). There plaintiff sought an injunction and defendant counterclaimed for treble damages under the antitrust laws. The lower court held that the suit under the pre-merger system would have been cognizable in equity and therefore denied a jury on the counterclaim. This court reversed, holding that, if legal claims were present, a jury was required; the blending of legal and equitable claims, which formerly would have resulted in exclusively equity jurisdiction, does not now destroy the right to a jury trial of the legal issues:

> ". . . Since in the federal courts equity has always acted only when legal remedies were inadequate, the expansion of adequate legal remedies provided by the Declaratory Judgment Act and the Federal Rules necessarily affects the scope of equity. Thus, the justification for equity's deciding legal issues once it obtains jurisdiction, and refusing to dismiss a case, merely because subsequently a legal remedy becomes available, must be re-evaluated in the light of the liberal joinder provisions of the Federal Rules which allow legal and equitable causes to be brought and resolved in one civil action." (359 U.S. at 509; footnote references eliminated.)

In *Dairy Queen, Inc.* v. *Wood,* 369 U.S. 469 (1962), this Court emphatically reaffirmed its holding in *Beacon Theatres.* In *Dairy Queen,* the complaint alleged that the

defendant was infringing the plaintiff's trademark and had breached a licensing agreement between the parties; it sought an injunction and an accounting. These were all, traditionally, "equitable" claims—just as the stockholder's derivative action is traditionally "equitable". Nonetheless, this Court held that, since money recovery was also sought, the right to jury trial is not destroyed. The Court stated:

> ". . . The holding in Beacon Theatres was that where both legal and equitable issues are presented in a single case, 'only under the most imperative circumstances, circumstances which in view of the flexible procedures of the Federal Rules we cannot now anticipate, can the right to a jury trial of legal issues be lost through prior determination of equitable claims.' That holding, of course, applies whether the trial judge chooses to characterize the legal issues presented as 'incidental' to equitable issues or not. Consequently, in a case such as this where there cannot even be a contention of such 'imperative circumstances,' Beacon Theatres requires that any legal issues for which a trial by jury is timely and properly demanded be submitted to a jury. There being no question of the timeliness or correctness of the demand involved here, the sole question which we must decide is whether the action now pending before the District Court contains legal issues." (369 U.S. at 472-73; footnote references eliminated.)

The *Dairy Queen* respondents attempted to qualify the rule by quantitative considerations. They contended that the equitable issues outweighed the legal issue, which was a mere incident to the equitable one. Without disputing the premise, this Court refused to weaken the right to a jury trial by the disintegrating erosion of particular exceptions.

> "'It is therefore immaterial that the case at bar contains a stronger basis for equitable relief than was present in Beacon Theatres. It would make no difference if the equitable cause clearly outweighed the legal cause so that the basic issue of the case taken as a whole is equitable. As long as *any* legal cause is involved the jury rights it creates control. This is the teaching of Beacon Theatres, as we construe it.' Thermo-Stitch, Inc. v. Chemi-Cord processing Corp. (CA5 Fla.) 294 F. 2d 486, 491." (369 U.S. at 473 n.8; emphasis added)

In the present case the Court of Appeals denied the right to a jury because "the assertion of any 'legal' claim on behalf of the corporation is totally *dependent* upon plaintiffs' successfully establishing their capacity to sue at equity. Thus in applying the Seventh Amendment the two portions of the complaint cannot be regarded as separable and divisible." (403 F. 2d at 914; emphasis supplied).

But this effort to distinguish this Court's holdings in *Beacon Theatres and Dairy Queen* does not withstand analysis. For the holding of these cases is that, where both legal and equitable issues are presented in a single case, the right to a jury trial must not be lost by the way in which "the trial judge chooses to characterize the legal issues" (*Dairy Queen, supra,* 369 U.S. at 473). In *Dairy Queen,* the trial court denied a jury, denigrating the legal issue by characterizing it as merely "incidental" to the equitable issue (369 U.S. 469, 470). In the present case, the Court of Appeals rationalizes denial of a jury by referring to the legal issues as "dependent" on the equitable issues. But, however the legal issues be labeled, there *is* a legal issue here. This is not questioned by the Court below.

And this Court has laid down the rule in terms so broad as to reject semantic erosion: "only under the most imperative circumstances . . . can the right to a jury trial of legal issues be lost through prior determination of equitable claims" *Beacon Theatres, supra* (359 U.S. at 510-511).

If indeed the right to a jury trial should depend on such elusive and unfunctional a concept as would require balancing the weight of the equity claim against that of the law claim, it is nevertheless plain that the dominant claims in this case as in most derivative cases are the underlying corporate claims. The fact that equity has fashioned a remedy which enables any shareholder of a corporation, immobilized by recreant directors, to rescue the corporation and bring it to the courthouse should not deprive the corporation or, for that matter, the defendants, of their right to a jury trial.

Thus, this Court has recognized that the important issue in stockholders' derivative actions is not the equitable question of whether the particular stockholder is entitled to maintain the action but, rather, the underlying substantive claim against the defendants. "The cause of action which such a [derivative] plaintiff brings before the Court is not his own but the corporation's. It is the real party in interest and he is allowed to act in protection of its interest somewhat as a 'next friend' might do for an individual, because it is disabled from protecting itself"; *Koster* v. *Lumbermens Mutual Cas. Co.*, 330 U.S. 518, 522-3 (1947). "The fact that [in a stockholder's derivative action] the corporation is nominally a defendant . . . gives the suit only a difference in form, not a difference in substance"; *Meyer* v. *Fleming*, 327 U.S. 161, 168 (1946).

Moreover, the emphasis of the Court below on the dependence of the legal claim is misplaced, for the underlying legal cause of action could have been brought directly by the corporation. The action is thus no more or less "unitary" (403 F.2d at 914) than the *Beacon Theatres* suit. Once the plaintiff in that case filed its bill in equity, the anti-trust claim became completely dependent thereon, incapable of prosecution as a separate action, since it was a compulsory counterclaim. *Moore* v. *New York Cotton Exchange*, 270 U.S. 593, 609-10 (1926).

The consequences of the Court of Appeals holding lead to intolerable results. If a director, broker or other person is sued by a corporation to recover a sum of money, he is entitled to a jury trial. If the same defendant is sued to recover the same sum of money by the same corporation, but the corporation is propelled by a shareholder in a derivative action, two possible alternatives result from the Court of Appeals holding: Either the defendant has lost his right to a jury trial, or, by insisting upon it, he can defeat the action altogether.* Either result is logically untenable and procedurally uncalled for. Granting such a defendant a jury trial on the legal issues comports not only with logic, but with precedent as well. For the rights of the parties cannot be made to depend on the procedural question of how the corporation came to sue the defendant:

---

* The latter result occurred prior to the merger of law and equity. *Fleitmann* v. *Welsbach Street Lighting Co.*, 240 U.S. 27 (1916), discussed *infra*, pp. 12-13. The Court of Appeals would return us to that era, ignoring the solution provided by the Federal Rules in permitting legal issues to be tried to the jury while the court decides equitable issues. See *Fanchon & Marco, Inc.* v. *Paramount Pictures, Inc.*, 202 F. 2d 731 (2 Cir. 1953), discussed *infra*, pp. 12-13.

> ". . . [T]he essential character of a cause of action belonging to a corporation remains the same, whether the suit to enforce it be brought by the corporation or by a share-holder. Thus a legal right of action would not be treated as an equitable one, or become governed by the rules applicable to equitable causes of action, as to limitations, etc., because a share-holder has brought suit in equity to enforce it on behalf of the company." *Potter* v. *Walker*, 276 N.Y. 15, 27, 11 N.E. 2d 335 (1937).

The exact issue passed upon by the Court below was decided in 1963 by the Ninth Circuit in *DePinto* v. *Provident Security Life Insurance Co.*, 323 F.2d 826 (9 Cir. 1963), cert. den. 376 U.S. 950, reh. den. 383 U.S. 973. In *DePinto*, the Court held that the right to a jury trial must be preserved in a stockholder's derivative action where such right would have existed had the suit been brought by the corporation in the first instance. The Court stated:

> "Thus, except under most imperative circumstances, a right to a jury trial on legal issues may not now be denied to a federal litigant on the ground that the case reached court only through equity, or because equitable rights are involved, or because the legal issues are 'incidental' to the equitable issues, or because substantive equitable remedies are sought, or by the device of trying the equitable issues first.
>
> "A stockholder's derivative action is an invention of equity to supply the want of an adequate remedy at law to redress breaches of fiduciary duty. Koster v. Lumbermens Mutual Casualty Co., 330 U.S. 518, 522, 67 S.Ct. 828, 91 L. Ed. 1067. The aid of equity is needed in order to establish the shareholder's right to sue in the corporate stead. Fanchon & Marco, Inc. v. Paramount Pictures, Inc., 2 Cir., 202 F. 2d 731,

734, 36 A.L.R. 2d 1336. But the claim set up is that of the corporation.

"In order to determine whether appellants were entitled to a jury trial in this derivative action, it is therefore necessary to ascertain whether any of the claims asserted against them on behalf of the corporation are of a kind which, if asserted by the corporation, would be cognizable in a suit at common law. If so, and if the judgment which has been entered, insofar as can be determined rests on claims of that kind, there has been a denial of trial by jury as guaranteed by the Seventh Amendment and appellants have been aggrieved thereby." (323 F. 2d at 836-37; footnote references eliminated)

In *Fanchon & Marco, Inc.* v. *Paramount Pictures, Inc.*, 202 F.2d 731 (2 Cir. 1953), the Court of Appeals held that in a derivative action where the underlying cause of action charges violation of the antitrust laws, there is a right to a jury trial which is not destroyed by the fact that the action is brought derivatively:

". . . The two major issues of right of the shareholder to sue and of violation of the antitrust laws causing damage to the corporation can be tried side by side or otherwise as may be convenient; that one may go to the jury while the other does not causes no difficulty." (202 F. 2d at 735)

The Court of Appeals here thought that the holding in *Fanchon* was dictum. Clearly, it was not. The defendants there had successfully obtained dismissal of the action by the District Court. They argued that they were entitled to a jury trial and that under the rationale of *Fleitmann* v. *Welsbach Street Lighting Co.*, 240 U.S. 27 (1916), decided prior to the merger of law and equity, a jury trial was not

available in a derivative stockholders' action. This, it was urged, required dismissal of the action. The Court of Appeals in *Fanchon* held, however, that the *Fleitmann* rationale did not apply to a merged system of law and equity since the derivative action could be maintained while still preserving defendants' right to a jury trial.

The Court below sought to distinguish *Fanchon* in that the underlying claim there was for treble damages under the antitrust laws. Thus, said the Court of Appeals, the jury trial right was statutory in *Fanchon* whereas here it is constitutional. This attempt at distinction misses the mark. In the first place, the right to a jury in an antitrust action is not provided by the statute but results simply from the fact that — as in the present case — a money judgment for damages may result. If the availability of such a judgment means that the statute contemplates a jury trial, then it must be said that § 44 of the Investment Company Act, 15 USC § 80a-43, which authorizes actions at law to enforce liabilities created by the Act, similarly confers a jury right. More importantly, however, it is difficult to see how a statutorily created right relating to the underlying cause of action could achieve greater sanctity than a similar constitutionally provided one. In short, the *Fanchon* case is not distinguishable from the present one.

A legal claim of a corporation, even though advanced in a derivative action, is triable before a jury. This Court has consistently rejected a variety of efforts to permit formalism to triumph over the substantive constitutional right to trial by jury.

II.

The underlying causes of action in the present case assert substantial legal claims giving rise to a right to jury trial.

As this Court held in *Dairy Queen, Inc.* v. *Wood*, 369 U.S. 469, 473n.8 (1962), "As long as any legal cause is involved the jury rights it creates control." In the present case the District Court found much more than the minimal requirement. It found "that this complaint states on behalf of the corporation a claim which is fundamentally legal rather than equitable." 275 F. Supp. 569, 571. The Court of Appeals decision makes no finding to the contrary.

The Complaint seeks a money recovery: brokerage commissions illegally paid by the Corporation, most of it to Lehman Brothers, which dominated the Corporation. In 1964 the Corporation paid brokerage commissions of $531,724. Of this sum $442,903 was paid to Lehman Brothers. Similarly, in 1965, the Corporation paid brokerage commissions of $538,622, of which $334,685 went to Lehman Brothers. Similar payments for 1966 were $405,772 and $351,640, respectively (A. 33). The defendants include, in addition to the directors of the Corporation, the partners of Lehman Brothers (A. 21).

The claims may be broken down as follows:

(1) Failure to utilize the third market. In order to generate commissions for themselves, Lehman Brothers caused the Corporation to execute transactions in listed securities on the New York Stock Exchange. These transactions could have been executed instead on the third market at more favorable prices, but such executions would not have resulted in commissions to Lehman Brothers (A. 23).

(2) Payment of unnecessary commissions to Lehman Brothers on over-the-counter transactions. When effecting transactions in unlisted securities, Lehman Brothers caused the Corporation needlessly to interpose themselves and to pay them unnecessary commissions. Instead, the Corporation could have dealt directly with principals and avoided those gratuitous payments for which no service of value was rendered (A. 23-24).

(3) Reciprocal brokerage. The Corporation has been caused to pay brokerage commissions to brokers who supplied information to Lehman Brothers. This effectively caused the Corporation to pay third parties for advice for which the Corporation had already paid Lehman Brothers (A. 24-25).

Several theories are asserted by which recovery may be had. It is asserted that, by virtue of the domination and control of the Corporation by Lehman Brothers, all brokerage commissions paid by the Corporation to Lehman Brothers are illegal under §§ 10(b) (1), 2(a) (3) and 2(a) (9) of the Investment Company Act, 15 USC §§ 80a-10(b) (1), 2(a) (3), 2(a) (9) (A. 25-26). It is also asserted that the reciprocal brokerage constitutes compensation to Lehman Brothers as investment adviser to the Corporation in excess of the amount specified in its investment advisory contract, thus breaching the investment advisory contract and violating the Investment Company Act (A. 25).

It is further asserted that the payment of brokerage commissions to Lehman Brothers and other brokers has constituted an unlawful and willful conversion by Lehman Brothers of the assets of the Corporation in violation of § 37 of the Act (A. 26). The payment of these brokerage commissions is also alleged to constitute gross abuse of trust, gross misconduct, willful misfeasance, bad faith,

gross negligence and a reckless disregard of fiduciary duties by the Corporation's officers, directors and brokers in violation of the Act (A. 26). Finally, it is asserted that the payments amount to a waste and spoliation of the Corporation's assets (A. 26).

The prayer for relief demands that the defendants be required "to account for and pay to the Corporation for their profits and gains and its losses." No injunctive or other extraordinary relief is sought (A. 27).

That causes of action seeking money recovery such as breach of contract, conversion, gross negligence and violation of statutory provisions are legal rather than equitable in nature is beyond question. Professor Moore states: "Actions which at common law . . . are jury actions . . . are: . . . suits for damages for negligence . . . for violation of . . . statutes . . . trover to recover damages for conversion of personal property . . . and special assumpsit — to recover damages on a simple contract." (5 Moore's Fed. Pr. 113-115 (1968), footnotes omitted).

In *DePinto, supra,* the Court held as follows:

> ". . . One ground for the judgment, applicable to all of the appellants, is gross negligence. Another ground, applicable to all appellants except Landoe, is breach of fiduciary duty.
>
> "An action brought by the corporation to recover damages against former officers or directors on the ground of negligence would be cognizable in a suit at common law. Kelly v. Dolan, 3 Cir., 233 F. 635. Thus all appellants were denied a jury trial on an issue cognizable in a suit at common law. Landoe was necessarily aggrieved by this denial since, as to him, this was the only basis of the judgment.
>
> * * * * *

> "Having in mind the necessity of scrutinizing, with utmost care, any seeming curtailment of the right to a jury trial, we hold that where a claim of breach of fiduciary duty is predicated upon underlying conduct, such as negligence, which is actionable in a direct suit at common law, the issue of whether there has been such a breach is, subject to appropriate instructions, a jury question. We therefore conclude that, in the context of this case, the question concerning breach of fiduciary duty, as well as negligence, should have been submitted to the jury." (323 F. 2d at 836-37; footnote references eliminated)

In the *DePinto* case, the claim involved the diversion of corporate assets in the purchase of allegedly worthless stock. Grounds for the judgment were gross negligence and breach of fiduciary duty. In the instant case the amended complaint asserts that assets of the Corporation have been diverted. The diversion is in the form of brokerage commissions, which are paid to Lehman Brothers and other brokers. As in *DePinto,* the diversion is caused by gross negligence and breach of fiduciary duty.

The present case seeks not only to charge the directors of the Corporation, but also asks for recovery from the Corporation's principal broker. In *Simler* v. *Conner*, 372 U.S. 221 (1963), this Court held that a case adjudicating the amount of fees which a client was obligated to pay his lawyer, whom he charged with overreaching, raised legal issues creating a right of jury trial. Clearly a controversy with a broker concerning the propriety of commissions paid to him is also a legal cause of action. *Schultz* v. *Manufacturers & Traders Trust Co.,* 128 F. 2d 889 (2 Cir. 1942), cert. den. 317 U.S. 674; Restatement of Agency 2d, Secs. 399 et seq.

The mere fact that the defendants are fiduciaries does not mean that the causes of action against them must be equitable. Thus, as the Court of Appeals for the Third Circuit held in *Kelly* v. *Dolan*, 233 F. 635, 637 (3 Cir. 1916):

> ". . . That the negligence of a director is an injury to his corporation, and that the right to recover for such negligence is a legal as contrasted with an equitable right, and that the corporation is vested with the right to recover for such injury, is established by authority. In some cases this right is asserted in equity; in some at law, according to circumstances; but in whatever form it is litigated the right to recover for negligence is a legal right."

See also, *Halladay* v. *Verschoor*, 381 F. 2d 100, 109 (8 Cir. 1967).

Nor does the possibility that the transactions may be numerous require a denial of the jury right. There is no reason to believe that the jury would not be equal to its role. The issues are considerably simpler than those involved in antitrust litigation, patent suits and a large variety of truly complex matters where juries are called upon to examine numerous transactions constituting the wrongs complained of. There is no justification for eroding the right to a jury trial here.

The mainstream of American political and jurisprudential thought has not shared the doubts of Alexander Hamilton as to the competence of juries, relied upon by respondents (Br. in Opp. to Pet. for Cert., p. 7).* Thus, in

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* "Hamilton's view, that constitutional protection of jury trial in civil cases was undesirable, did not prevail. On the contrary, in response to widespread demands from the various State Constitutional Conventions, the first Congress adopted the Bill of Rights containing the Sixth and Seventh Amendments, intended to save trial in both criminal and common law cases from legislative or judicial abridgement." *Galloway* v. *United States*, 319 U.S. 372, 396, 398 (1943; dissenting opinion).

Sioux City & Pacific R.R. v. *Stout,* 84 U.S. 657, 664 (1873), the Court said:

> ". . . Twelve men of the average of the community, comprising men of education and men of little education, men of learning and men whose learning consists only in what they have themselves seen and heard, the merchant, the mechanic, the farmer, the laborer; these sit together, consult, apply their separate experience of the affairs of life to the facts proven, and draw a unanimous conclusion. This average judgment thus given it is the great effort of the law to obtain. It is assumed that twelve men know more of the common affairs of life than does one man; that they can draw wiser and safer conclusions from admitted facts thus occurring, than can a single judge."

See also *Travelers Insurance Co.* v. *Selden,* 78 Fed. 285, 287 (4 Cir. 1897); Crane, *Judge and Jury,* 15 A.B.A.J. 201, 202 (1929); Caldwell, *Trial by Judge and Jury,* 33 Am. L. Rev. 321, 329-38 (1899); Tongue, *In Defense of Juries As Exclusive Judges of the Facts,* 35 Ore. L. Rev. 143, 161-66 (1956).

What is sought by way of relief here is a judgment for a sum of money. As this Court held in *Dairy Queen, supra,* this is the determinative factor. No extraordinary relief for which courts of law are inadequate is required, notwithstanding the fact that the prayer uses the word account.

> "The respondents' contention that this money claim is 'purely equitable' is based primarily upon the fact that their complaint is cast in terms of an 'accounting,' rather than in terms of an action for 'debt' or 'damages.' But the constitutional right to trial by jury cannot be made to depend upon the

> choice of words used in the pleadings. The necessary prerequisite to the right to maintain a suit for an equitable accounting, like all other equitable remedies, is, as we pointed out, in Beacon Theatres, the absence of an adequate remedy at law. Consequently, in order to maintain such a suit on a cause of action cognizable at law, as this one is, the plaintiff must be able to show that the 'accounts between the parties' are of such a 'complicated nature' that only a court of equity can satisfactorily unravel them. In view of the powers given to District Courts by Federal Rule of Civil Procedure 53(b) to appoint masters to assist the jury in those exceptional cases where the legal issues are too complicated for the jury adequately to handle alone, the burden of such a showing is considerably increased and it will indeed be a rare case in which it can be met. But be that as it may, this is certainly not such a case. A jury, under proper instructions from the court, could readily determine the recovery, if any, to be had here, whether the theory finally settled upon is that of breach of contract, that of trademark infringement, or any combination of the two. The legal remedy cannot be characterized as inadequate merely because the measure of damages may necessitate a look into petioner's business records." (*Dairy Queen, Inc.* v. *Wood*, 369 U.S. 469, 477-79; footnote references eliminated)

See also, *Swofford* v. *B &W, Inc.*, 336 F.2d 406, 410-11 (5 Cir. 1964), cert. den. 379 U.S. 962.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals for the Second Circuit should be reversed.

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JUN 6 1969
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

No. ~~982~~ 42

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,

Petitioners,

—against—

ROBERT A. BERNHARD, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS

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IN THE

Supreme Court of the United States

October Term, 1968

No. 992

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,

Petitioners,

—v.—

ROBERT A. BERNHARD, *et al.*,

Respondents.

BRIEF FOR RESPONDENTS

Constitutional Provisions, Statutes and Rules Involved

The Seventh Amendment to the Constitution of the United States, the Act of June 19, 1934 (48 Stat. 1064), §2072 of title 28, U.S.C., Rule 38 of the Federal Rules of Civil Procedure and Equity Rule 27 (226 U.S. 656) are set forth in an appendix to this brief.

The Questions Presented

1. Irrespective of the nature of the claim asserted on behalf of the corporation, does the plaintiff in a stockholder's derivative suit have a personal constitutional right to trial by jury of the claim asserted on behalf of the corporation?

2. In a stockholder's derivative suit for a judgment which would require officers and directors to account for and pay to the corporation their profits and gains and its losses allegedly arising out of breaches of fiduciary duty, does the plaintiff stockholder have a personal constitutional right to trial by jury of the claim asserted on behalf of the corporation?

Statement of the Case

This stockholders' derivative suit is brought on behalf of The Lehman Corporation, a closed-end investment company which is registered as such under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 et seq.* The claims asserted in the second amended complaint are in substance as follows:

(1) Lehman Brothers, acting as the corporation's investment adviser and principal broker, executes the corporation's portfolio transactions in *listed* securities on the securities exchanges on which they are listed rather than off such exchanges in the so-called "third market", where it is alleged that such transactions could be executed at more favorable prices (A. 23).

(2) In executing portfolio transactions in *unlisted* or over-the-counter securities, Lehman Brothers has "interposed" itself between the corporation and those securities dealers with whom the corporation could allegedly deal directly at more favorable prices (A. 23).

---

* The second amended complaint alleges that plaintiffs sue representatively on behalf of the corporation's shareholders as well as derivatively on behalf of the corporation, but plaintiffs conceded in the District Court that they sought no relief except on behalf of the corporation (A. 46). (The references are to the indicated pages of the Appendix.)

(3) Lehman Brothers receives excessive investment advisory compensation by reason of the fact that approximately 15% of the corporation's brokerage commissions are allocated to brokers who provide investment advice to Lehman Brothers (A. 24-25).

(4) The board of directors of the corporation is unlawfully constituted in that at least 50% of its members are affiliated with or controlled by Lehman Brothers (A. 25-26).

All of this, the second amended complaint alleges, constitutes (A. 26):

> "... an unlawful and willful conversion by Lehman Brothers and the individual defendants of the monies, funds, property and assets of the Corporation to the use of Lehman Brothers ... and gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence and a reckless disregard of their fiduciary duties by the Corporation's officers, directors and brokers in violation of the duties which the Act ... expressly and by necessary implication imposes upon officers, directors and brokers of investment companies."

The relief demanded is a judgment "requiring the defendants jointly and severally to account for and pay to the Corporation for their profits and gains and its losses." (A. 27).

All defendants moved in the District Court to strike plaintiffs' demand for trial by jury. The District Court denied the motion and the Court of Appeals for the Second Circuit reversed.

ARGUMENT

I

A plaintiff in a stockholder's derivative suit has no constitutional right to trial by jury

The issue here is whether in a stockholder's derivative suit—a creature of equity unknown to the common law—a plaintiff stockholder has a constitutional right to trial by jury. The decision which petitioners challenge was clearly correct in its statement and application of the controlling constitutional standard: Was there a right to jury trial in a stockholder's derivative suit at the time of the enactment of the Seventh Amendment in 1791 or, indeed, at any subsequent time? The Court of Appeals correctly held that the stockholder's suit has always been a suit in equity and that there was no right to jury trial in such a suit.

The constitutional right to trial by jury stems from the Seventh Amendment, which provides:

> "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law."

Rule 38(a) of the Federal Rules of Civil Procedure, preserves the Seventh Amendment right, providing:

> "(a) RIGHT PRESERVED. The right of trial by jury as declared by the Seventh Amendment to the Constitution or as given by a statute of the United States shall be preserved to the parties inviolate."

This Court has made it clear that history is the criterion by which the right to trial by jury is to be determined. *Parsons* v. *Bedford*, 28 U.S. (3 Pet.) 433 (1830); *Dimick* v. *Schiedt*, 293 U.S. 474, 476 (1935); *Baltimore & C. Line* v. *Redman*, 295 U.S. 654, 660 (1935). In the *Schiedt* case the Court stated the test:

> "In order to ascertain the scope and meaning of the Seventh Amendment, resort must be had to the appropriate rules of the common law established at the time of the adoption of that constitutional provision in 1791. *Thompson* v. *Utah*, 170 U.S. 343, 350; *Patton* v. *United States*, 281 U.S. 276, 288. . . ."

The teaching of history is that whether before or after 1791, in England as well as in the United States, the stockholder's derivative suit was a creature of equity. There never was any right to trial by jury in such a suit.

The first stockholder's derivative suit to come to this Court was *Dodge* v. *Woolsey*, 59 U.S. (18 How.) 331 (1855). In that case, the Court stressed that the "stockholder's bill" was an invention of equity "for prevention of injuries for which common-law courts were inadequate":

> "We will consider the points in their order. The first comprehends two propositions, namely: that courts of equity have no jurisdiction over corporations, as such, at the suit of a stockholder for violations of charters, and none for the errors of judgment of those who manage their business ordinarily.
>
> "There has been a conflict of judicial authority in both. Still, it has been found necessary, for prevention of injuries for which common-law courts were inadequate, to entertain in equity such a jurisdiction in the progressive development of the powers and

effects of private corporations upon all the business and interests of society.

"It is now no longer doubted, either in England or the United States, that courts of equity, in both, have a jurisdiction over corporations, at the instance of one or more of their members; to apply preventive remedies by injunction, to restrain those who administer them from doing acts which would amount to a violation of charters, or to prevent any misapplication of their capitals or profits, which might result in lessening the dividends of stockholders, or the value of their shares, as either may be protected by the franchises of a corporation, if the acts intended to be done create what is in the law denominated a breach of trust. And the jurisdiction extends to inquire into, and to enjoin, as the case may require that to be done, any proceedings by individuals, in whatever character they may profess to act, if the subject of complaint is an imputed violation of a corporate franchise, or the denial of a right growing out of it, for which there is not an adequate remedy at law. 2 Russ. & Mylne Ch. R., Cunliffe v. Manchester and Bolton Canal Company, 480, n.; Ware v. Grand Junction Water Company, 2 Russ. & Mylne, 470; Bagshaw v. Eastern Counties Railway Company, 7 Hare Ch. R. 114; Angell & Ames, 4th ed. 424, and the other cases there cited." 59 U.S. at 341.

The equitable remedy approved by this Court in *Dodge* v. *Woolsey* soon became the subject of abuse as corporations procured stockholders to bring derivative suits to take advantage of diversity jurisdiction that might not otherwise be available. In *Hawes* v. *Oakland,* 104 U.S. 450 (1881), the Court attempted to curb such abuses by holding that a stockholder could not sue on behalf of the corporation unless he held its stock at the time of the wrong complained of and

unless the corporation refused, despite honest efforts by the stockholder, to bring the action on its own behalf. The Court said:

> "... it is equally important that before the shareholder is permitted in his own name to institute and conduct a litigation which usually belongs to the corporation, he should show to the satisfaction of the court that he has exhausted all the means within his reach to obtain, within the corporation itself, the redress of his grievances, or action in conformity to his wishes. He must make an earnest, not a simulated effort, with the managing body of the corporation, to induce remedial action on their part, and this must be made apparent to the court. If time permits or has permitted, he must show, if he fails with the directors, that he has made an honest effort to obtain action by the stockholders as a body, in the matter of which he complains. And he must show a case, if this is not done, where it could not be done, or it was not reasonable to require it.
>
> "The efforts to induce such action as complainant desires on the part of the directors, and of the shareholders when that is necessary, and the cause of failure in these efforts should be stated with particularity, and an allegation that complainant was a shareholder at the time of the transactions of which he complains, or that his shares have devolved on him since by operation of law, and that the suit is not a collusive one to confer on a court of the United States jurisdiction in a case of which it could otherwise have no cognizance, should be in the bill, which should be verified by affidavit." 104 U.S. at 460, 461.

The precaution devised in *Hawes* v. *Oakland* was almost simultaneously promulgated as Equity Rule 94 (104 U.S. ix). That Rule, with only minor revision, became Equity

Rule 27 in 1913 (226 U.S. 629, 656) and later the original Rule 23 of the Federal Rules of Civil Procedure.

Clearly then, the stockholder's derivative suit, since first recognized by the Supreme Court, has been considered a creature of equity and specifically treated as such in the Equity Rules. As Mr. Justice Jackson said in *Koster* v. *Lumbermens Mutual Co.*, 330 U.S. 518, 522 (1947), eight years after the Equity Rules were "merged" into the Federal Rules of Civil Procedure:

> "The stockholder's derivative action, to which this policyholder's action is analogous, is an invention of equity to supply the want of an adequate remedy at law to redress breaches of fiduciary duty by corporate managers. Usually the wrongdoing officers also possess the control which enables them to suppress any effort by the corporate entity to remedy such wrongs. Equity therefore traditionally entertains the derivative or secondary action by which a single stockholder may sue in the corporation's right when he shows that the corporation on proper demand has refused to pursue a remedy, or shows facts that demonstrate the futility of such a request. With possible rare exceptions, these actions involve only issues of state law and, as in the present case, can get into federal courts only by reason of diversity in citizenship of the parties. Their existence and peculiar character were recognized by this Court in the old Equity Rules. Rule 27, 226 U.S. 656."

Petitioners do not dispute that the stockholder's derivative suit is an invention of equity and that historically no right to trial by jury was recognized (Br. 5). They contend instead—despite the plain language of the Seventh Amendment—that all was changed by the merger of law and equity

which was effected by the adoption of the Federal Rules of Civil Procedure in 1938 and by this Court's decisions in *Dairy Queen* v. *Wood*, 369 U.S. 469 (1962) and *Beacon Theatres* v. *Westover*, 359 U.S. 500 (1957).

Petitioners rest upon the theory that the stockholder asserts two separate claims in a derivative suit—an equitable claim against the corporation for failure to bring suit against the alleged wrongdoer, and a legal claim on behalf of the corporation—and that courts of equity historically took jurisdiction of the second claim only as a function of their now obsolete "clean-up" power to dispose of related legal issues in order that a litigant not be required to institute an additional suit at law. Petitioners contend that now, with the merger of law and equity, the first claim can be tried to the court and the second to a jury.

One flaw in this ingenious theory (for which no authority is cited) is that the clean-up doctrine was not the basis for equity's jurisdiction over derivative suits. Pomeroy in his authoritative treatise exhaustively examines the many kinds of suit in which clean-up jurisdiction was exercised, but derivative suits are nowhere mentioned in this connection. 1 POMEROY, EQUITY JURISPRUDENCE, pp. 410-458 (5th ed. 1941). Pomeroy explains the basis of equity jurisdiction over derivative suits as follows:

> "Although the corporation holds all the title, legal or equitable, to the corporate property, and is the *immediate cestui que trust* under the directors with respect to such property, and is theoretically the only proper party to sue for wrongful dealings with that property, yet courts of equity recognize the truth that the stockholders are *ultimately* the only beneficiaries; that their rights are really, though in-

> directly, protected by remedies given to the corporation; and that the final object of suits by the corporation is to maintain the interests of the stockholders. . . . Wherever a cause of action exists primarily in behalf of the corporation against directors, officers, and others, for wrongful dealing with corporate property, or wrongful exercise of corporate franchises, so that the remedy should reguarly be obtained through a suit by and in the name of the corporation, and the corporation *either actually or virtually refuses* to institute or prosecute such a suit, then, in order to prevent a failure of justice, an action may be brought and maintained by a stockholder or stockholders, either individually or suing on behalf of themselves and all others similarly situated, against the wrong-doing directors, officers, and other persons; . . ." 4 POMEROY, *op. cit. supra*, at 276, 277.

Clearly, as this Court's early decisions confirm (see *Dodge* v. *Woolsey, supra; Hawes* v. *Oakland, supra*), equity jurisdiction over derivative suits was not in any sense predicated upon the clean-up doctrine.

A second flaw in petitioners' theory is that the two elements of a derivative claim were never considered separate and divisible for purposes of determining the right to jury trial. As this Court stated in *Dairy Queen* v. *Wood, supra*, at 470, 471, prior to the promulgation of the Federal Rules of Civil Procedure in 1938, federal equity courts could not take jurisdiction of suits in which legal and equitable claims were joined. *Scott* v. *Neely*, 140 U.S. 106 (1891); *Cates* v. *Allen*, 149 U.S. 451 (1893). To do so would have created a "conflict with the constitutional provision by which the right to a trial by jury is secured." *Cates* v. *Allen*,

supra, at 457. Yet it is undisputed that federal courts did accept jurisdiction of derivative suits. In consistently recognizing between 1855 and 1938 that stockholder's derivative suits were maintainable in the federal equity courts, this Court necessarily rejected the notion that for the purpose of determining rights to jury trial, derivative suits consisted of separate legal and equitable claims.

The right to jury trial in derivative actions has been considered many times by courts and commentators since the remedy was first recognized. Save for the Ninth Circuit in *DePinto* v. *Provident Security Life Insurance Company*, 323 F.2d 826 (9th Cir. 1963), *cert. denied*, 376 U.S. 950 (1964) and the District Court in the present case, all have agreed that the equitable nature of the action precludes the right to jury trial. *Brinckerhoff* v. *Bostwick*, 105 N.Y. 567 (1887); *Bookbinder* v. *Chase National Bank of New York*, 244 App. Div. 2d 650 (1st Dep't 1935); *Anderson* v. *Derrick*, 220 Cal. 770, 32 P.2d 1078 (1934); *Metcalf* v. *Shamel*, 166. Cal. App. 2d 789, 333 P.2d 857 (2d Dist. 1959); *Morton* v. *Morton Realty Co.*, 41 Idaho 729, 241 Pac. 1014 (1925); *Neff* v. *Barber*, 165 Wis. 503, 162 N.W. 667 (1917); *Steinway* v. *Griffith Consol. Theatres*, 273 P.2d 872 (Okla. 1954). 13 FLETCHER, PRIVATE CORPORATIONS, § 5931 (Rev. ed. 1961); 2 HORNSTEIN, CORPORATION LAW AND PRACTICE, ¶ 730 (1959); LATTIN, CORPORATIONS, ch. 8 § 3 (1959); Note, *The Right to a Jury Trial in a Stockholder's Derivative Action*, 74 Yale L.J. 725 (1965).

Judge Mansfield, in following the long line of authority cited above in *Richland* v. *Crandall*, 259 F. Supp. 274, 279-80 n. 8 (S.D.N.Y. 1966), stated well the error in the *DePinto* reasoning. He wrote:

> "That decision, in this court's opinion, rests upon the erroneous assumption that if the *corporation* could have made any of the claims the subject of a 'Suit at common law' entitling *it* to demand a jury trial under the Seventh Amendment, the stockholder suing derivatively would also be entitled to do so. This reasoning ignores the fact that the corporation's suit could be one at common law, whereas the stockholders' derivative suit could not. In effect the court in DePinto divided one derivative suit into two actions (1) a suit by the shareholder, and (2) a suit by the corporation, whereas in fact there is but one action, an equity suit by the shareholder which must be brought exclusively in equity, regardless of the relief sought."

The Court below put it even more succinctly (A. 69):

> "It is from the fountainhead of equity that this entire litigation flows, and we see no justification for artificially dividing the suit into two parts for the purposes of applying the Seventh Amendment."

History is decisive here and compels the result reached below by the Court of Appeals.

II

The claim asserted on behalf of the corporation is equitable in nature and hence not triable to a jury

Petitioners' second amended complaint belies on its face their characterization of their claim as legal in nature. The complaint clearly and unequivocally accuses the defendants of fraud and overreaching, of willful and deliberate breaches of duties which are alleged to be "fiduciary" (pars.

15, 17, 21, 22). It seeks as relief an accounting for "profits" allegedly illgotten through breach of defendants' fiduciary duty as officers, directors and investment advisors.

Traditionally such a claim was cognizable only in equity, where the remedy was fashioned out of existing trust law. *Attorney-General* v. *The Governors of the Foundling Hospital*, 2 Ves. Jun. 43 (1793); *Adley* v. *The Whitstable Company*, 17 Ves. Jun. 315 (1810).

> "There is nothing better established, than that this Court does not entertain a general jurisdiction to regulate and control charities established by charter. There the establishment is fixed and determined; and the Court has no power to vary it. If the Governors, established for the regulation of it, are not those, who have the management of the revenues, this Court has no jurisdiction; and, if it is ever so much abused, as far as respects the jurisdiction of this Court, it is without remedy: but if those, established as Governors, have also the management of the revenues, this Court does assume a jurisdiction of necessity, so far as they are to be considered as trustees of the revenue. That is stated in the book upon charitable uses; and referred to in several authorities; particularly in *Attorney-General* v. *Smart*, 1 *Ves. sen.* 72, and *Attorney-General* v. *Middleton*, 2 *Ves. sen.* 327. The result is, this Court must not hastily take upon itself to interfere with those, who have by charter, and in this case by act of Parliament, the whole control over this charity. But where, having also the management of the revenues, they are abusing their trust, the Court has jurisdiction." 2 Ves. Jun. at 47.

Claims such as this have always been regarded as equitable in nature in this country as well. Here too they arose

in equity as a natural extension of equity's jurisdiction over trustees. *Robinson* v. *Smith*, 3 Paige Ch. 221, 231 (N.Y. 1832):

> "I have no hesitation in declaring it as the law of this State that the directors of a moneyed or other joint-stock corporation, who willfully abuse their trust or misapply the funds of the company, by which a loss is sustained, are personally liable, as trustees, to make good that loss. And they are equally liable if they suffer the corporate funds or property to be lost or wasted by gross negligence and inattention to the duties of their trust. Independent of the provisions of the Revised Statutes, which were passed after the filing of this bill, this court had jurisdiction, so far as the individual rights of the corporators were concerned, to call the directors to account, and compel them to make satisfaction for any loss arising from a fraudulent breach of trust or the willful neglect of a known duty. To this extent *Chancellor* Kent, in the case of *Attorney-General* v. *Utica Ins. Co.*, 2 Johns. Ch. 389, admitted the court had jurisdiction, although he doubted the general powers of this court over the corporation itself to prevent an abuse of its corporate privileges. Until very recently but few incorporated companies in which individuals had any direct pecuniary interest existed in England, except corporations for charitable purposes. And this court would very reluctantly interfere with the concerns of mere municipal corporations, where a sufficient remedy is afforded by *mandamus* or *quo warranto*, or by an indictment against the officers of the corporation, for any abuse of their powers, by which the public has sustained an injury. But since the introduction of joint-stock corporations, which are mere partnerships, except in form, the principles which were formerly applied to charitable corporations in England may be very

> appropriately extended to such companies here. The directors are the trustees or managing partners, and the stockholders are the *cestuis que trust,* and have a joint interest in all the property and effects of the corporation. See Wood, Inst. bk. 1, chap. 8, p. 110; 11 Co. 98, *b.* And no injury the stockholders may sustain by a fraudulent breach of trust can, upon the general principles of equity, be suffered to pass without a remedy."

As the Second Circuit said more recently in another connection in *Schine* v. *Schine,* 367 F. 2d 685, 687 (2d Cir. 1966):

> "Plaintiffs' fourth claim, for an accounting based on defendants' alleged breaches of their fiduciary duty as officers, directors, and majority stockholders, would have been cognizable in equity before the merger of law and equity."

To the same effect is *Miller* v. *Weiant,* 42 F. Supp. 760, 761 (E.D. Ohio 1942):

> "The Court is persuaded that this is a suit in equity. It is not denied that a corporation may maintain a suit against its officers and directors, or any of them, for an accounting of funds and assets entrusted to them which have been dissipated by their fraud or negligence. In such a case, the suit has always been in equity, the officers and directors being considered as quasi trustees of the assets."

Similarly, in *In re The Van Sweringen Co.,* 119 F.2d 231, 235 (6th Cir. 1941), the Court stated:

> "Where the directors of a corporation, contrary to their fiduciary duty, have made a personal profit in their dealings with the corporation, equity will compel them to account to the corporation for such profits made at its expense."

Nothing in *Dairy Queen, Inc.* v. *Wood*, supra, suggests a contrary view. There the plaintiff sued, among other things, upon "a written licensing contract . . . under which [defendant] agreed to pay some $150,000", alleging that defendant was in default under the contract "in excess of $60,000.00", and sought "an accounting to determine the exact amount of money owing" (369 U.S. at 473, 475). The Court held that the claim, although labeled "accounting", was truly legal in nature (369 U.S. at 477):

> "As an action on a debt allegedly due under a contract, it would be difficult to conceive of an action of a more traditionally legal character."

In such a case, the Court found, the plaintiff's characterization of its claim as one for an accounting could not defeat the defendant's right to trial by jury.

Here on the other hand, plaintiffs do not rely upon any contract, but upon the fiduciary relationships alleged to exist between The Lehman Corporation and the individual defendants (A. 26). There is no specific amount of damages claimed. Plaintiffs do not seek to recover a debt, but pray for defendants "to account for and pay to the Corporation for their profits and gains and its losses" (A. 27).

Moreover, unlike the cases cited in petitioners' brief, the gravamen of the complaint here is not mere negligence. Paragraphs 21 and 22 (A. 26) allege that payment of the brokerage commissions under attack were "willful" acts (par. 21), constituting "a waste and spoliation of the Corporation's assets for the benefit and profit of Lehman Brothers and the individual defendants." (par. 22). Paragraph 17 (A. 24) ascribes the actions of the corporation to the fact that "Lehman Brothers, which dominates and con-

trols the Corporation, prefers to profit at the Corporation's expense and to its detriment." The word "negligence" appears only once, and that is in the latter part of paragraph 21, where it is included as one of a string of epithets totally inconsistent with mere negligence, gross or otherwise.*

Petitioners' reliance on *Simler* v. *Connor*, 372 U.S. 221, 222 (1963) is misplaced. That case was a declaratory judgment action to determine the amount due under a contingent fee contract. As the Court's opinion and the cases cited—*Trist* v. *Child*, 88 U.S. (21 Wall.) 441, 447 (1874) and *Stanton* v. *Embrey*, 93 U.S. 548 (1876)—make clear, the basis of decision was the fact that the suit was in essence a contract action. Here, as has been pointed out previously, petitioners do not sue on a contract, but upon an alleged fiduciary relationship between respondents and the corporation.

Even were petitioners correct that their claim was legal in nature, they still would not be entitled to a jury trial. This Court in *Dairy Queen* recognized that even "on a cause of action cognizable at law," the issues involved may be so complicated that "only a court of equity can satisfac-

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* The full text of paragraph 21 is as follows:

"21. The payment of these brokerage commissions to Lehman Brothers and others has constituted and continues to constitute an unlawful and willful conversion by Lehman Brothers and the individual defendants of the monies, funds, property and assets of the Corporation to the use of Lehman Brothers in violation of Sec. 37 of the Act; and gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence and a reckless disregard of their fiduciary duties by the Corporation's officers, directors and brokers in violation of the duties which the Act (Secs. 1(b)(2), 10, 17(h) and (i) and 36) expressly and by necessary implication imposes upon officers, directors and brokers of investment companies."

torily unravel them", 369 U.S. at 478. Manifestly this is such a case.

The complexity of the action is obvious from the complaint. It alleges that over the past five years, Lehman Brothers has received approximately $2,000,000 in brokerage commissions from the corporation (A. 22). In those five years there were many thousands of separate portfolio transactions aggregating scores of millions of dollars. Alleging that some of these thousands of transactions were improperly executed at excessive cost to the corporation, plaintiffs seek an accounting for defendants' "profits".

Since plaintiffs allege one species of breach of trust in connection with transactions in listed securities and quite another in connection with transactions in unlisted securities, the task confronting the trier of fact will be to examine the two types of transactions separately. The trier of fact may be required to cull from many thousands of transactions in listed securities those which plaintiffs claim could have been executed off the exchange in the so-called "third market" and to determine with respect to each such transaction whether the "third market" offered advantages to the corporation which the defendants unlawfully forsook. With respect to over-the-counter transactions, the trier of fact may be required to determine with respect to each whether Lehman Brothers was unnecessarily "interposed", and if so, whether the corporation was damaged and in what amount. And if any transactions, whether in listed or in unlisted securities, are found to have been unlawful, the trier of fact may be required to determine as to each the extent to which defendants profited unlawfully. Thus, each of many thousands of transactions may require a pre-

cise and obviously difficult measurement of claimed disadvantage to the corporation.

It would be a perversion of history to suggest that the dissatisfaction with the Constitution as first presented to the states for adoption and which gave rise to the first ten amendments was rooted in any conviction that cases of such complexity should be tried by veniremen of the community. The contemporaneous literature demonstrates, to the contrary, a recognition that "nice and intricate" issues of this character "are incompatible with the genius of trials by jury."

As Hamilton pointed out in THE FEDERALIST while the first ten amendments were being considered by the states:

> ". . . the circumstances that constitute cases proper for courts of equity, are in many instances so nice and intricate, that they are incompatible with the genius of trials by jury. They require often such long and critical investigation, as would be impracticable to men called occasionally from their occupations, and obliged to decide before they were permitted to return to them. The simplicity and expedition which form the distinguishing characters of this mode of trial require, that the matter to be decided should be reduced to some single and obvious point; while the litigations usually in chancery, frequently comprehend a long train of minute and independent particulars." THE FEDERALIST, No. 83, p. 621.

See also Warren, *New Light on the History of the Federal Judiciary Act of 1789*, 37 Harv. L. Rev. 49-132 (1934).

CONCLUSION

The order of the Court of Appeals should be affirmed.

Respectfully submitted,

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June 6, 1969

APPENDIX

APPENDIX

Constitutional Provisions, Statutes and Rules Involved

Seventh Amendment

"In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law."

Act of June 19, 1934 (48 Stat. 1064)

"AN ACT

"To give the Supreme Court of the United States authority to make and publish rules in actions at law.

"*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That the Supreme Court of the United States shall have the power to prescribe, by general rules, for the district courts of the United States and for the courts of the District of Columbia, the forms of process, writs, pleadings, and motions, and the practice and procedure in civil actions at law. Said rules shall neither abridge, enlarge, nor modify the substantive rights of any litigant. They shall take effect six months after their promulgation, and thereafter all laws in conflict therewith shall be of no further force or effect.

"Sec. 2. The court may at any time unite the general rules prescribed by it for cases in equity with those in actions at law so as to secure one form of civil action and procedure for both: *Provided, however,* That in such union of rules the right of trial by jury as at common law and declared

by the seventh amendment to the Constitution shall be preserved to the parties inviolate. Such united rules shall not take effect until they shall have been reported to Congress by the Attorney General at the beginning of a regular session thereof and until after the close of such session."

28 U.S.C. § 2072

"§ 2072. RULES OF CIVIL PROCEDURE

"The Supreme Court shall have the power to prescribe, by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeals of the United States in civil actions, including admiralty and maritime cases, and appeals therein, and the practice and procedure in proceedings for the review by the courts of appeals of decisions of the Tax Court of the United States and for the judicial review or enforcement of orders of administrative agencies, boards, commissions, and officers.

"Such rules shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury as at common law and as declared by the Seventh Amendment to the Constitution.

"Such rules shall not take effect until they have been reported to Congress by the Chief Justice at or after the beginning of a regular session thereof but not later than the first day of May, and until the expiration of ninety days after they have been thus reported.

"All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect. Nothing

in this title, anything therein to the contrary notwithstanding, shall in any way limit, supersede, or repeal any such rules heretofore prescribed by the Supreme Court. As amended May 24, 1949 c. 139, §103, 63 Stat. 104: July 18, 1949, c. 343, §2, 63 Stat. 446; May 10, 1950, c. 174, §2, 64 Stat. 158; July 7, 1958, Publ. L. 85-508, §12(m), 72 Stat. 348; Nov. 6, 1966 Public L. 89-773, §1, 80 Stat. 1323."

Rule 38 (Federal Rules of Civil Procedure)

"JURY TRIAL OF RIGHT

"(a) RIGHT PRESERVED. The right of trial by jury as declared by the Seventh Amendment to the Constitution or as given by a statute of the United States shall be preserved to the parties inviolate.

"(b) DEMAND. Any party may demand a trial by jury of any issue triable of right by a jury by serving upon the other parties a demand therefor in writing at any time after the commencement of the action and not later than 10 days after the service of the last pleading directed to such issue. Such demand may be indorsed upon a pleading of the party.

"(c) SAME; SPECIFICATION OF ISSUES. In his demand a party may specify the issues which he wishes so tried; otherwise he shall be deemed to have demanded trial by jury for all the issues so triable. If he has demanded trial by jury for only some of the issues, any other party within 10 days after service of the demand or such lesser time as the court may order, may serve a demand for trial by jury of any other or all of the issues of fact in the action.

"(d) WAIVER. The failure of a party to serve a demand as required by this rule and to file it as required by Rule 5(d) constitutes a waiver by him of trial by jury. A demand for trial by jury made as herein provided may not be withdrawn without the consent of the parties.

"(e) ADMIRALTY AND MARITIME CLAIMS. These rules shall not be construed to create a right to trial by jury of the issues in an admiralty or maritime claim within the meaning of Rule 9(h). As amended Feb. 28, 1966, eff. July 1, 1966."

Equity Rule 27 (226 U.S. 656)

"STOCKHOLDER'S BILL.

"Every bill brought by one or more stockholders in a corporation against the corporation and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since by operation of law, and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance. It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders, and the causes of his failure to obtain such action, or the reasons for not making such effort."

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IN THE

Supreme Court of the United States

October Term, 1968

No. 992

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,

Petitioners,

—v.—

ROBERT A. BERNHARD, *et al.*,

Respondents,

and

PAUL L. DAVIES, *et al.*,

Defendants.

REPLY BRIEF FOR PETITIONERS

I.

A corporation's legal cause of action is triable to a jury whether it is asserted by the corporation itself or by a stockholder derivatively on its behalf.

The nub of respondents' argument, and of the decision below, is that a corporation's legal claim, triable by jury, is transmuted into an equitable cause when a stockholder asserts it derivatively on behalf of the corporation. The proposition, we submit, is contrary to reason and controlling precedent.

1. *Fleitmann* v. *Welsbach Street Lighting Co.*, 240 U.S. 27 (1916), was a stockholder's derivative action for treble damages under the antitrust laws. The Court noted that "the claim set up is that of the corporation alone;" if asserted by the corporation, it would be at law and triable to a jury (p. 28). This raised the question of whether "the defendants' right to a jury trial should be taken away" just because a stockholder, unable to induce action by his corporation, brought the suit derivatively on its behalf.

The Court, by Mr. Justice Holmes, answered the question in the negative. The damage claim was at law. It did not lose its legal nature through assertion in a derivative suit. The derivative suit did *not* transmute the legal into an equitable claim. The right to jury trial remained intact and inviolate.

Under then existing procedure, this conclusion was fatal to the plaintiff. In 1916 law and equity were separate. Fleitmann had brought his suit on the equity side of the district court. Equity alone gave him standing to sue on behalf of the corporation. But an equity court could not conduct a jury trial. The complaint thus had to be dismissed.

So far as *Fleitmann* dealt with the jury issue, it controls the present case. Here, as in *Fleitmann*, a stockholder asserts his corporation's legal claims derivatively on its behalf. Here, as in *Fleitmann*, the claims, no matter how asserted, remain what they are, claims at law belonging to the corporation. Here, as in *Fleitmann*, the derivative action does not impair the parties' right to jury trial of the legal claims.

What has changed since the days of *Fleitmann* are the consequences flowing from this state of affairs. Law

and equity have been merged by the adoption of the Federal Rules in 1938. The same court can now administer legal and equitable relief in the same case. The equitable issues are tried by the court, the legal issues by a jury. Under its equity powers, the court determines, without a jury, whether the complaining stockholder has the requisite standing to sue derivatively on behalf of the corporation. In the same suit, however, the court can try the corporation's legal cause of action to a jury. No more room, therefore, is left today for a dismissal such as was necessary in the pre-merger era of *Fleitmann*. The right to jury trial, recognized by this Court in *Fleitmann*, can now be given full scope and effect.

2. The decision below misconceived the impact of *Fleitmann*. The majority of the court read the case as holding that "there could be no right to a jury trial in the equitable derivative action" (A67). The opinion overlooked that *Fleitmann* sustained the right to jury trial; it merely held that an equity court could not administer it. This obstacle has disappeared under the Federal Rules.

The majority below also sought to distinguish *Fleitmann* as relating "only to the *statutory* right to jury trial created by the Sherman Act" (A68; emphasis by the court). The attempted distinction between the constitutional and the statutory jury right rests on several erroneous premises.

In the first place, the antitrust laws create no right to jury trial. In fact, neither the Sherman Act nor the Clayton Act so much as mentions trial by jury. The two Acts do create the right to treble damages; but it is the Seventh Amendment to the Constitution which provides for the

trial of the claim by jury. 5 *Moore's Fed. Pr.* ¶ 38.11[5] at 113-14 (2d Ed. 1968).*

Secondly, even if the right to jury trial of treble damage claims had a statutory basis, it is difficult to see why the statutory right should enjoy greater sanctity than the constitutional right to a jury. If a statutory jury right survives in a derivative suit, the jury right created by the Constitution cannot be more fragile.

Finally, if the Sherman and Clayton Acts were thought to imply a statutory right to jury trial, the same must be said of the Investment Company Act, under which the present action is brought (A20). Section 44 of that Act, 15 USC § 80a-43, expressly provides for "actions at law brought to enforce any liability or duty created by" the Act. If the statutory basis of the jury right be relevant at all, the Investment Company Act provides that basis no less than the Sherman and Clayton Acts.**

We submit, therefore, that *Fleitmann* cannnot be distinguished from the present case. It clearly establishes petitioners' right to a jury trial of the underlying corporate claim.

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* See *Leimer* v. *Woods*, 196 F. 2d 828, 834 (8 Cir. 1952): The right to jury trial of double damage claims under the Emergency Price Control Act falls within the jury trial guaranty of the Seventh Amendment.

** The majority below refused to consider this argument in the belief that it had not been raised in the district court and that the record was insufficient to enable the court to address the issue (A68, n. 1). In fact, however, petitioners *had* raised the same argument in their district court brief of August 25, 1967 (p. 7). Moreover, since petitioners had prevailed in the district court, they were free to advance any arguments, even new ones, to sustain that court's decision; *Letulle* v. *Scofield*, 308 U.S. 415, 421, at n. 8 (1940). Finally, it is obscure in what respects the record below is supposed to have been insufficient; the effect of § 44 of the Investment Company Act is a pure question of law.

3. Respondents maintain (Br. 10-11) that the two elements of a derivative suit—the corporation's cause of action and the stockholder's right to assert it—were never deemed to be separate for jury trial purposes. Prior to 1938, they say, legal and equitable claims could not be joined in one equity action; *Scott* v. *Neely*, 140 U.S. 106 (1891); *Cates* v. *Allen*, 149 U.S. 451 (1893). Yet the federal courts did accept jurisdiction of derivative suits. It follows, according to respondents, that this Court must have rejected the notion that derivative suits can involve separate legal and equitable rights.

Respondents' syllogism is faulty. In the two decisions of this Court which they cite—*Dodge* v. *Woolsey*, 59 U.S. (18 How.) 331 (1855), and *Hawes* v. *Oakland*, 104 U.S. 450 (1882)—the underlying claims, seeking an injunction, were equitable, so that the problem of combining legal with equitable claims in a single derivative suit did not arise. The one case in which the problem did arise was *Fleitmann;* and there the Court did bar the assertion of a legal claim as incompatible with the equitable character of a derivative suit.

In this context, Mr. Justice Holmes addressed himself to the very point which respondents raise here: If a corporation's legal claim could not be asserted in an equity suit such as a stockholder's action, how could the federal courts ever accept jurisdiction of derivative suits? The answer was simple. In other derivative cases, the underlying corporate claim had been equitable; or, if it was legal, the defendants had not insisted on their jury rights. As stated by Justice Holmes *(Fleitmann,* 240 U.S. at 28-29):

> "No doubt there are cases in which the [equitable] nature of the right asserted for the company,

> or the failure of the defendants concerned to insist upon their [jury] rights, or a different state system, has led to the whole matter being disposed of in equity; * * * " [Parenthetical interpolations added]

In short, for purposes of determining the right to jury trial, it was well settled even before 1938 that the corporation's underlying claim presented issues wholly separate from those pertaining to the stockholder's standing. Indeed, the recognition of the dual nature of the derivative suit has its root in *Hawes* v. *Oakland*, 104 U.S. 450, 452-53 (1882), where the Court viewed the stockholder's derivative action as combining "two causes of action":

> "one against his own company, of which he is a corporator, for refusing to do what he has requested them to do; and the other against the party which contests the matter in controversy with that corporation."

Accord: *Ballantine, Corporations*, § 145 at 343-44 (Rev. Ed. 1946); 13 *Fletcher, Corporations*, § 5946 at 429 (M. Wolf Ed. 1961) (both with numerous citations); *Halpern* v. *Pennsylvania R. Co.*, 189 F. Supp. 494, 498 (E.D.N.Y. 1960); *Riviera Congress Associates* v. *Yassky*, 18 N.Y. 2d 540, 547, 277 N.Y.S. 2d 386, 392, 223 N.E. 2d 876 (1966).

The adoption of the Federal Rules in 1938 has not changed the dual nature of the derivative suit; but it has eliminated the procedural impediments to jury trial of the legal issues involved in such an action. The leading case on the subject, *Fanchon & Marco* v. *Paramount Pictures*, 202 F. 2d 731, 735 (2 Cir. 1953), so held; and it has been consistently followed by later decisions. *Rogers* v. *American Can Co.*, 305 F. 2d

297, 307-8 (3 Cir. 1962); *Ramsburg* v. *American Investment Co.*, 231 F. 2d 333, 339 (7 Cir. 1956); *DePinto* v. *Provident Security Life Ins. Co.*, 323 F. 2d 826, 836-37 (9 Cir. 1963), cert. den. 376 U.S. 950; *Schechtman v. Wolfson*, 244 F. 2d 537, 539 (2 Cir. 1957); *Kogan* v. *Schenley Industries*, 20 F.R.D. 4 (D. Del. 1956); *Gomberg* v. *Midvale Co.*, 157 F. Supp. 132, 140-41 (E.D. Pa. 1955).

We submit that petitioners' right to trial by jury of the corporation's cause of action is not to be denied just because the claim is asserted in a stockholders' derivative action.

II.

The underlying causes of action of the corporation are legal claims triable by jury.

The District Court held that this action, viewed as one brought by the Corporation, is "a suit at common law" within the meaning of the Seventh Amendment (A46-48). The majority of the Court of Appeals did not reach the question (A64), but the dissenting Judge agreed with the District Court that the action is at law because it is "for a money judgment for unlawful conversion, breach of fiduciary duty, fraud and gross negligence" (A72-73).

Respondents contend that an action against corporate directors for breach of fiduciary duty cannot be brought at law and that, in any event, the complexity of this action would force it into equity.

1. Contrary to respondents' assertion, *damage claims* for breaches of duty by corporate directors are traditionally at law, unless the legal remedy is inadequate. In

Hazard v. *Wight,* 201 N.Y. 399, 94 N.E. 855 (1911), the defendant president and director caused his corporation to pay him part of its capital. The court held (201 N.Y. at 402):

> "The defendant thereby violated the statute [citation] and the principles of the common law and became liable in an action at law to the corporation for wasting its assets."

Accord, e.g., *DePinto* v. *Provident Security Life Ins. Co.,* 323 F. 2d 826, 836-37 (9 Cir. 1963), *cert. den.* 376 U.S. 950 (1964); *Kelly* v. *Dolan,* 233 Fed. 635, 637 (3 Cir. 1916); *O'Brien* v. *Fitzgerald,* 143 N.Y. 377, 380-81, 38 N.E. 371 (1894); *Potter* v. *Walker,* 276 N.Y. 15, 26, 11 N.E. 2d 335, 337 (1937); *Kocon* v. *Cordeiro,* 98 R.I. 772, 200 A. 2d 708, 710-11 (1964); *Minister L. & S. Co.* v *Laufersweler,* 37 Ohio App. 375, 36 N.E. 2d 895 (1940).

The present action alleges a claim for damages. The legal remedy is adequate. In light of the discovery procedures of the Federal Rules, neither an equitable discovery nor an equitable accounting is necessary. The prayer of the complaint for an accounting may be ignored. *Dairy Queen* v. *Wood,* 369 U.S. 469, 477-78 and n. 19 (1962); *Beacon Theatres* v. *Westover,* 359 U.S. 500, 509-10 (1959).

2. Respondents suggest (Br. 16) that an action at law lies only for negligent (as distinguished from willful) fiduciary breaches. The present complaint does allege negligence (A26). The scope of the action at law is not, however, limited to negligence. The notion that a jury may find a fiduciary to be negligent but must bow out if it finds a higher degree of fault defies both reason and authority. In *Schine* v. *Schine,* 367 F. 2d 685 (2 Cir. 1966)—a case invoked by

respondents—the second count of the complaint sought damages for the fraud of the defendant fiduciaries; the court held that the claim was at law and triable by jury.* Willful conversion, such as is here alleged (A26), is likewise a familiar area of jury competence, *United States* v. *Bitter Root Dev. Co.*, 200 U.S. 451, 472 (1906). A fiduciary chargeable with conversion, see *Brown* v. *Bullock*, 294 F. 2d 415, 420 (2 Cir. 1961), cannot sidestep a jury just because he is a fiduciary. This is equally true of a claim for waste of corporate assets; *Hazard* v. *Wight, supra*, 201 N.Y. 399, 402, 94 N.E. 855.

3. Respondents' liability for the profits they derived from their breaches of duty is likewise cognizable at law. Although claims of that character have often been entertained in equity, *Schine* v. *Schine, supra; In re The Van Sweringen Co.*, 119 F. 2d 231, 235 (6 Cir. 1941), they need not be. A fiduciary who profits from his breach of duty is unjustly enriched. He is liable in assumpsit for money had and received. *B. F. Goodrich Co.* v. *Naples*, 121 F. Supp. 345, 347-48 (S.D. Cal. 1954); *Gottfried* v. *Gottfried*, 269 App. Div. 413, 56 N.Y.S. 2d 50, 56 (1945); *Wagner* v. *Armsby*, 264 App. Div. 379, 35 N.Y.S. 2d 488, 489 (1942). Although this quasi-contractual form of action employs equitable principles, it is, nevertheless, an action at law, one of the common counts, and hence is triable by jury. See *Myers* v. *Hurley Motor Co.*, 273 U.S. 18, 24 (1927); *Okeechobee County* v. *Nuveen*, 145 F. 2d 684, 687 and n. 5 (5 Cir. 1944); *Restatement, Restitution*, pp. 5-9 (1937). In fact, the accounting claim in *Dairy Queen, supra*, which this Court held

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*The fourth count, seeking an accounting of profits, was held to be equitable. The nature of the second and fourth counts appears from the record of the *Schine* case.

to be triable to a jury, sought "an accounting of profits"; see the lower court's decision in that case, *McCullough* v. *Dairy Queen*, 194 F. Supp. 686, 687 (E.D. Pa. 1961).*

4. Respondents argue that the complexity of the claims necessitates their trial in equity. Complexity as such is not, however, an obstacle to jury trial. *Curriden* v. *Middleman*, 232 U.S. 633, 636 (1914):

> "* * * mere complication of facts alone and difficulty of proof are not a basis of equity jurisdiction."

Accord: *United States* v. *Bitter Root Dev. Co.*, 200 U.S. 451, 472 (1906).

An exception to this broad rule used to apply where "the accounts between the parties" were of such a complicated nature that only a court of equity could satisfactorily unravel them. *Kirby* v. *Lake Shore & M.S.R. Co.*, 120 U.S. 130, 134 (1887); *Dairy Queen* v. *Wood*, 369 U.S. 469, 478 (1962). Respondents themselves do not contend that this action is based on "the accounts between the parties". An account could arise, as it did in *Kirby*, from a long-drawn contractual relationship between the parties. By contrast, a mere multiplicity of torts, such as is here alleged, was never thought to create an "account" and never afforded the wrongdoer an escape from the jury.

In any case, equity's jurisdiction of complicated accounts has, under modern practice, shrunk to the point of disappearance; *Dairy Queen* v. *Wood*, *supra*, 369 U.S. at 478:

> "In view of the powers given to District Courts by Federal Rule of Civil Procedure 53(b) to appoint masters to assist the jury in those exceptional cases where the legal issues are too complicated for the

* See also p. 6 of the Brief for Respondents in this Court in *Dairy Queen*.

> jury adequately to handle alone, the burden of such a showing [that only equity can unravel the complicated accounts] is considerably increased and it will indeed be a rare case in which it can be met." (Parenthetical interpolation added; footnotes omitted)

The present action is not that "rare case". The experienced trial judge below held that "[t]he issues are not so complicated as to make it impracticable for a jury to ascertain the amount, if any, to which plaintiffs may be entitled" (A47). Judge Smith in the Court of Appeals agreed that "[t]he issues are not so complex as to be beyond the competence of a trial jury" (A73).

Respondents' apprehension that "many thousands of separate portfolio transactions" must be scrutinized would not take the case into equity and is, in any event, unfounded. Petitioners do not propose to present their evidence in such piecemeal fashion. They propose to prove, from respondents' own admissions, that respondents engaged deliberately and systematically in the improper practices here alleged. If persistent wrongdoing on respondents' part emerges, the Corporation's damages may well be measured by the readily ascertainable amount of respondents' compensation, *Wilshire Oil Co.* v. *Riffe*, 406 F. 2d 1061 (10 Cir. 1969); and the same will be true if the illegal composition of the Corporation's board of directors (Compl. par. 19; A25-26) invalidates the Corporation's relationship to the respondent broker, see *Phillips* v. *S.E.C.*, 388 F. 2d 964, 966 (2 Cir. 1968).

None of these issues presents inordinate difficulties for a jury. If unexpected complications were to develop, the jury might receive the help of a master, Rule 53(b) FRCP; *Dairy Queen, supra.* These and other details may safely be

left to the trial court and can be dealt with at the pre-trial conference, Rule 16 FRCP. The time, we submit, has passed when technicalities of that nature could stand in the way of the constitutional right to jury trial.

CONCLUSION

The judgment of the Court of Appeals for the Second Circuit should be reversed.

Dated: October 14, 1969.

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OPINION

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D.C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 42.—October Term, 1969

Howard Ross and Bernard Ross, as Trustees for Lena Rosenbaum, Petitioners, *v.* Robert A. Bernhard et al. | On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[February 2, 1970]

Mr. Justice White delivered the opinion of the Court.

The Seventh Amendment to the Constitution provides that in "Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved." Whether the Amendment guarantees the right to a jury trial in stockholders' derivative actions is the issue now before us.

Petitioners brought this derivative suit in federal court against the directors of their closed-end investment company, The Lehman Corporation, and the corporation's brokers, Lehman Brothers. They contended that Lehman Brothers controlled the corporation through an illegally large representation on the corporation's board of directors, in violation of the Investment Company Act of 1940, 15 U. S. C. § 80a–1 *et seq*, and used this control to extract excessive brokerage fees from the corporation. The directors of the corporation were accused of converting corporate assets and of "gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence." Both the individual defendants and Lehman Brothers were accused of breaches of fiduciary duty. It was alleged that the payments to Lehman Brothers constituted waste and spoliation, and that the contract between the corporation and Lehman Brothers had been violated. Petitioners requested that the defendants

"account for and pay to the Corporation for their profits and gains and its losses." Petitioners also demanded a jury trial on the corporation's claims.

On motion to strike petitioners' jury trial demand, the District Court held that a shareholder's right to a jury on his corporation's cause of action was to be judged as if the corporation were itself the plaintiff. Only the shareholder's initial claim to speak for the corporation had to be tried to the judge. 275 F. Supp. 569. Convinced that "there are substantial grounds for difference of opinion as to this question and . . . an immediate appeal would materially advance the ultimate termination of this litigation," the District Court permitted an interlocutory appeal. 28 U. S. C. § 1292 (b). The Court of Appeals reversed, holding that a derivative action was entirely equitable in nature, and no jury was available to try any part of it. 403 F. 2d 909. It specifically disagreed with *DePinto* v. *Provident Security Life Ins. Co.*, 323 F. 2d 826 (C. A. 9th Cir. 1963), cert. denied, 376 U. S. 950 (1964), on which the District Court had relied. Because of this conflict, we granted certiorari. 394 U. S. 917 (1969).

We reverse the holding of the Court of Appeals that in no event does the right to a jury trial preserved by the Seventh Amendment extend to derivative actions brought by the stockholders of a corporation. We hold that the right to jury trial attaches to those issues in derivative actions as to which the corporation, if it had been suing in its own right, would have been entitled to a jury.

The Seventh Amendment preserves to litigants the right to jury trial in suits at common law—

> "not merely suits, which the common law recognized among its old and settled proceedings, but suits in which legal rights were to be ascertained and determined, in contradistinction to those, where equitable rights alone were recognized, and equitable remedies

were administered . . . . In a just sense, the amendment then may well be construed to embrace all suits, which are not of equity and admiralty jurisdiction, whatever may be the peculiar form which they may assume to settle legal rights." *Parsons* v. *Bedford*, 3 Pet. 433, 446 (1830).

However difficult it may have been to define with precision the line between actions at law dealing with legal rights and suits in equity dealing with equitable matters, *Whitehead* v. *Shattuck*, 138 U. S. 146, 151 (1891), some proceedings were unmistakably actions at law triable to a jury. The Seventh Amendment, for example, entitled the parties to a jury trial in actions for damages to a person or property, for libel and slander, for recovery of land, and for conversion of personal property.[1] Just as clearly, a corporation, although an artificial being, was commonly entitled to sue and be sued in the usual forms of action, at least in its own State. See *Paul* v. *Virginia*, 8 Wall. 168 (1868). Whether the corporation was viewed as an entity separate from its stockholders or as a device permitting its stockholders to carry on their business and to sue and be sued, a corporation's suit to enforce a legal right was an action at common law carrying the right to jury trial at the time the Seventh Amendment was adopted.[2]

The common law refused, however, to permit stockholders to call corporate managers to account in actions at law. The possibilities for abuse, thus presented, were not ignored by corporate officers and directors. Early in the 19th century, equity provided relief both in this country and in England. Without detailing these

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[1] See, *e. g.*, *Curriden* v. *Middleton*, 232 U. S. 633 (1914); *Whitehead* v. *Shattuck*, 138 U. S. 146 (1891); 5 J. Moore, Federal Practice ¶38.11[5].

[2] 1 W. Blackstone, Commentaries *475; cf. *Bank of Columbia* v. *Patterson's Adm'r*, 7 Cranch 299 (1813); *Bank of Kentucky* v. *Wister*, 2 Pet. 318 (1829).

developments,[3] it suffices to say that the remedy in this country, first dealt with by this Court in *Dodge* v. *Woolsey*, 18 How. 331 (1856), provided redress not only against faithless officers and directors but against third parties who had damaged or threatened the corporate properties and whom the corporation through its managers refused to pursue. The remedy made available in equity was the derivative suit, viewed in this country as a suit to enforce a *corporate* cause of action against officers, directors and third parties. As elaborated in the cases, one precondition for the suit was a valid claim on which the corporation could have sued; another was that the corporation itself had refused to proceed after suitable demand, unless excused by extraordinary conditions.[4] Thus the dual nature of the stockholders' action: first the plaintiff's right to sue on behalf of the corporation and second the merits of the corporation claim itself.[5]

Derivative suits posed no Seventh Amendment problems where the action against the directors and third

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[3] Prunty, The Shareholders' Derivative Suit: Notes on Its Derivation, 32 N. Y. U. L. Rev. 980 (1957), treats the development of the equitable remedy.

[4] *Delaware & Hudson Co.* v. *Albany & S. RR. Co.*, 213 U. S. 435 (1909); *Doctor* v. *Harrington*, 196 U. S. 579 (1905); *Quincy* v. *Steel*, 120 U. S. 241 (1887); *Hawes* v. *Oakland*, 104 U. S. 450 (1881). Soon after *Hawes* v. *Oakland*, *supra*, the preconditions to a shareholder's suit were promulgated as Equity Rule 94, 104 U. S. IX, which became Equity Rule 27, 226 U. S. 656 (1912), then Fed. Rule Civ. Proc. 23 (b), 308 U. S. 690 (1938), and is now Fed. Rule Civ. Proc. 23.1, 383 U. S. 1050 (1966).

[5] See *Koster* v. *Lumbermens Mut. Cas. Co.*, 330 U. S. 518, 522–523 (1947); *Ashwander* v. *TVA*, 297 U. S. 288, (1936). See also 13 W. Fletcher, Cyclopedia Corporations § 5941.1 (1961 ed.); 2 G. Hornstein, Corporation Law and Practice § 716; 4 J. Pomeroy, Equity Jurisprudence § 1095, at 278 (5th ed.). Insofar as the stockholders may have been asserting their own direct interest, they closely resemble other class action plaintiffs who could proceed, before merger, only in equity.

parties would have been by a bill in equity had the corporation brought the suit. Our concern is with cases based upon a legal claim of the corporation against directors or third parties. Does the trial of such claims at the suit of a stockholder and without a jury violate the Seventh Amendment?

The question arose in this Court in the context of a derivative suit for treble damages under the antitrust laws. *Fleitmann* v. *Welsbach Street Lighting Co.*, 240 U. S. 27 (1916). Noting that the bill in equity set up a claim of the corporation alone, Mr. Justice Holmes observed that if the corporation were the plaintiff, "no one can doubt that its only remedy would be at law," and inquired "why the defendants' right to a jury trial should be taken away because the present plaintiff cannot persuade the only party having an interest in the cause of action to sue—how the liability which is the principal matter can be converted into an incident of the plaintiff's domestic difficulties with the company that has been wronged"? His answer was that the bill did not state a good cause of action in equity. Agreeing that there were "cases in which the nature of the right asserted for the company, or the failure of the defendants concerned to insist on their rights, or a different state system, has led to the whole matter being disposed of in equity," he concluded that when the penalty of triple damages is sought, the antitrust statute plainly anticipated a jury trial and should not be read as "attempting to authorize liability otherwise than through the verdict of a jury in a court of common law." Although the decision had obvious Seventh Amendment overtones, its ultimate rationale was grounded in the antitrust laws.[6]

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[6] The dilemma of the stockholder seeking treble damages for the corporation became real and complete in *United Copper Sec. Co.* v.

Where penal damages were not involved, however, there was no authoritative parallel to *Fleitmann* in the federal system squarely passing on the applicability of the Seventh Amendment to the trial of a legal claim presented in a pre-merger derivative suit. What can be gleaned from this Court's opinions [7] is not inconsistent with the general understanding, reflected by the state court decisions and secondary sources, that equity could properly resolve corporate claims of any kind without a jury when properly pleaded in derivative suits complying with the equity rules.[8]

Amalgamated Copper Co., 244 U. S. 261 (1917), where the stockholder-plaintiff sought treble damages in an action at law. The Court rejected the claim by reiterating the traditional view that a shareholder was without standing to sue at law on a corporate cause. The treble damage action was a legal proceeding and only the corporation could bring it. The Court of Appeals for the Second Circuit has held that the federal rules have resolved the dilemma and that derivative actions for treble damages under the anti-trust laws are now proper. *Fanchon & Marco, Inc.* v. *Paramount Pictures, Inc.*, 202 F. 2d 731 (C. A. 2d Cir. 1953). Cf. *Ramsburg* v. *American Inv. Co. of Ill.*, 231 F. 2d 333 (C. A. 7th Cir. 1956). See generally, Comment: Federal Antitrust Law—Stockholders' Remedies For Corporate Injury Resulting From Antitrust Violations: Derivative Antitrust Suit and Fiduciary Duty, 59 Mich. L. Rev. 904 (1961).

[7] For example, in *Amalgamated Copper* the Court noted that in *Quincy* v. *Steel*, 120 U. S. 241 (1887), a shareholder's bill in equity which sought to enforce "a purely legal claim of the corporation—damages for breach of contract" was dismissed "not because the suit should have been at law, but because the bill failed to show that complainant had made sufficient effort to induce the directors to enter suit." 244 U. S, at 264, n. 2. *Delaware & Hudson Co.* v. *Albany & Susquehanna R. Co.*, *supra*, n. 4, involved a derivative suit for money damages due under a lease. The stockholders' right to sue was sustained; no jury trial issue appears to have been raised.

[8] See, *e. g.*, *Goetz* v. *Manufacturers' & Traders' Trust Co.*, 154 Misc., 733, 277 N. Y. Supp. 802 (Sup. Ct. 1935); *Isaac* v. *Marcus*, 258 N. Y. 257, 179 N. E. 487 (1932); *Morton* v. *Morton Realty*

Such was the prevailing opinion when the Federal Rules of Civil Procedure were adopted in 1938. It continued until 1963 when the Court of Appeals for the Ninth Circuit, relying on the Federal Rules as construed and applied in *Beacon Theatres Inc.* v. *Westover*, 359 U. S. 500 (1959), and *Dairy Queen Inc.* v. *Wood*, 369 U. S. 469 (1962), required the legal issues in a derivative suit to be tried to a jury.[9] *DePinto* v. *Provident Security Life Ins. Co.*, 323 F. 2d 826. It was this decision which the District Court followed in the case before us and which the Court of Appeals rejected.

Beacon and *Dairy Queen* presaged *DePinto*. Under those cases, where equitable and legal claims are joined in the same action, there is a right to jury trial on the legal claims which must not be infringed either by trying the legal issues as incidental to the equitable ones or by a court trial of a common issue existing between the claims. The Seventh Amendment question depends on the nature of the issue to be tried rather than the character of the overall action.[10] See *Simler* v. *Conner*,

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Co., 41 Idaho 729, 241 P. 1014 (1925); *Neff* v. *Barber*, 162 N. W. 667 (Sup. Ct. Wis. 1917); *Robinson* v. *Smith*, 3 Paige 222, 231, 233 (N. Y. 1832); 4 W. Cook, Corporations § 734 (1923 ed.); S. Thompson & J. Thompson, Law of Corporations § 4661 (Supp. 1931); 6 S. Thompson & J. Thompson, Law of Corporations § 4653 (1927 ed.).

[9] The possibility that the merged federal practice altered the procedures in derivative suits was early recognized, *Fanchon & Marco, Inc.* v. *Paramount Pictures, Inc.*, *supra*, n. 6, but until the action of the District Court below *DePinto* was alone in holding that a right to a jury trial existed in derivative actions. Cf. *Richland* v. *Crandall*, 259 F. Supp. 274 (D. C. S. D. N. Y. 1966). See also *Metcalf* v. *Shamel*, 166 Cal. App. 2d 789, 333 P. 2d 857 (1959); *Steinway* v. *Griffith Consol. Theatres*, 273 P. 2d 872 (Okla., 1954).

[10] As our cases indicate, the "legal" nature of an issue is determined by considering, first, the pre-merger custom with reference to such questions; second, the remedy sought; and, third, the practical abilities and limitations of juries. Of these factors, the

372 U. S. 221 (1963). The principle of these cases bears heavily on derivative actions.

We have noted that the derivative suit has dual aspects: first, the stockholder's right to sue on behalf of the corporation, historically an equitable matter; second, the claim of the corporation against directors or third parties on which, if the corporation had sued and the claim presented legal issues, the company could demand a jury trial. As implied by Mr. Justice Holmes in *Fleitmann*, legal claims are not magically converted into equitable issues by their presentation to a court of equity in a derivative suit. The claim pressed by the stockholder against directors or third parties "is not his own but the corporation's." *Koster* v. *Lumbermens Mut. Cas. Co.*, 330 U. S., at 522. The corporation is a necessary party to the action; without it the case cannot proceed. Although named a defendant, it is the real party in interest, the stockholder being at best the nominal plaintiff. The proceeds of the action belong to the corporation and it is bound by the result of the suit.[11] The heart of the action is the corporate claim. If it presents a legal issue, one entitling the corporation to a jury trial under the Seventh Amendment, the right to a jury is not forfeited merely because the stockholder's right to sue must first be adjudicated as an equitable issue triable to the court. *Beacon* and *Dairy Queen* require no less.

If under older procedures, now discarded, a court of equity could properly try the legal claims of the corporation presented in a derivative suit, it was because irreparable injury was threatened and no remedy at law

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first, requiring extensive and possibly abstruse historical inquiry, is obviously the most difficult to apply. See James, Right to a Jury Trial in Civil Actions, 72 Yale L. J. 655 (1963).

[11] See *Koster* v. *Lumbermens Mut. Cas. Co.*, 330 U. S. 518 (1947); *Meyer* v. *Fleming*, 327 U. S. 161, 167 (1946); *Davenport* v. *Dows*, 18 Wall. 626 (1873).

existed as long as the stockholder was without standing to sue and the corporation itself refused to pursue its own remedies. Indeed, from 1789 until 1938, the judicial code expressly forbade courts of equity from entertaining any suit for which there was an adequate remedy at law.[12] This provision served "to guard the right of trial by jury preserved by the Seventh Amendment and to that end it shall be liberally construed." *Schoenthal* v. *Irving Trust Co.*, 287 U. S. 92, 94 (1932). If, before 1938, the law had borrowed from equity, as it borrowed other things, the idea that stockholders could litigate for their recalcitrant corporation, the corporate claim, if legal, would undoubtedly have been tried to a jury.

Of course, this did not occur, but the Federal Rules had a similar impact. Actions are no longer brought as actions at law or suits in equity. Under the Rules there is only one action—a "civil action"—in which all claims may be joined and all remedies are available. Purely procedural impediments to the presentation of any issue by any party, based on the difference between law and equity, were destroyed. In a civil action presenting a stockholder's derivative claim, the court after passing upon the plaintiff's right to sue on behalf of the corporation is now able to try the corporate claim for damages with the aid of a jury.[13] Separable claims may be tried

[12] The Judicial Code of 1911, § 267, 36 Stat. 1163, re-enacting the Act of Sept. 24, 1789, c. 20, § 16, 1 Stat. 82, provided: "Suits in equity shall not be sustained in any court of the United States in any case where a plain, adequate, and complete remedy may be had at law."

[13] It would appear that the same conclusions could have been reached under Equity Rule 23 and the Law and Equity Act of 1915, Act of March 3, 1915, c. 90, 38 Stat. 956. See *Southern Ry. Co.* v. *City of Greenwood*, 40 F. 2d 679 (D. C. W. D. S. C. 1928); 2 J. Moore, Federal Practice ¶ 2.05. Rule 23 provided:

"If in a suit in equity a matter ordinarily determinable at law arises, such matter shall be determined in that suit according to the

separately, Fed. Rule Civ. Proc. 42 (b), or legal and equitable issues may be handled in the same trial. *Fanchon & Marco, Inc.* v. *Paramount Pictures, Inc.*, 202 F. 2d 731 (C. A. 2d Cir. 1953). The historical rule preventing a court of law from entertaining a shareholder's suit on behalf of the corporation is obsolete; it is no longer tenable for a district court, administering both law and equity in the same action, to deny legal remedies to a corporation, merely because the corporation's spokesmen are its shareholders rather than its directors. Under the rules, law and equity are procedurally combined; nothing turns now upon the form of the action or the procedural devices by which the parties happen to come before the court. The "expansion of adequate legal remedies by . . . the Federal Rules necessarily affects the scope of equity." *Beacon Theatres, Inc.* v. *Westover*, 359 U. S., at 509.

Thus, for example, before merger class actions were largely a device of equity, and there was no right to a jury even on issues which might, under other circumstances, have been tried to a jury. 5 J. Moore, Federal Practice ¶ 38.38 [2]; 3B J. Moore, Federal Practice ¶ 23.02 [1]. Although at least one post-merger court held that the device was not available to try legal issues,[14] it now seems settled in the lower federal courts that class action plaintiffs may obtain a jury trial on any legal issues they present. *Montgomery Ward & Co.* v. *Langer*, 168 F. 2d 182 (C. A. 8th Cir. 1948); see *Oskoian* v. *Canuel*, 269 F. 2d 311 (C. A. 1st Cir. 1959), aff'ing 23 F. R. D. 307, *Syres* v. *Oil Workers Int'l Union, Local 23*, 257 F. 2d 479 (C. A. 5th Cir. 1958), cert. denied.

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principles applicable, without sending the case or question to the law side of the court."

[14] *Farmers Co-operative Oil Co.* v. *Socony-Vacuum Oil Co.*, 43 F. Supp. 735 (D. C. N. D. Io. 1942).

358 U. S. 929. 2 W. Barron & A. Holtzoff, Federal Practice and Procedure § 571 (Wright ed.).

Derivative suits have been described as one kind of a "true" class action. 2 W. Barron & A. Holtzoff, Federal Practice and Procedure § 562.1 (Wright ed.). We are inclined to agree with the description, at least to the extent it recognizes that the derivative suit and the class action were both ways of allowing parties to be heard in equity who could not speak at law.[15] 3B J. Moore ¶¶ 23.02 [1], 23.1.16 [1]. After the rules there

[15] Other equitable devices are used under the rules without depriving the parties employing them of the right to a jury trial on legal issues. For example, although the right to intervene may in some cases be limited, *United States ex rel. Browne & Bryan Lumber Co.* v. *Massachusetts Bonding & Ins. Co.*, 303 F. 2d 823 (C. A. 3d Cir. 1962); *Dickinson* v. *Burnham*, 197 F. 2d 973 (C. A. 2d Cir. 1952), cert. denied 244 U. S. 875, when intervention is permitted generally, the intervenor has a right to a jury trial on any legal issues he presents. See 3B J. Moore, Federal Practice, ¶ 24.16 [7]; 5 J. Moore, Federal Practice, ¶ 38.38 [3]. A similar development seems to be taking place in the lower courts in interpleader actions. Before merger interpleader actions lay only in equity, and there was no right to a jury even on issues which might, under other circumstances, have been tried to a jury. *Liberty Oil Co.* v. *Condon Nat. Bank*, 260 U. S. 235 (1922). This view continued for some time after merger, see *Bynum* v. *Prudential Life Ins. Co.*, 7 F. R. D. 585 (D. C. E. D. S. C. 1947), but numerous courts and commentators have now come to the conclusion that the right to a jury should not turn on how the parties happen to be brought into court. See *Pan American Fire & Cas. Co.* v. *Revere*, 188 F. Supp. 474 (D. C. E. D. La. 1960); *Savannah Bank & Trust Co.* v. *Block*, 175 F. Supp. 798 (D. C. S. D. Ga. 1959); *Westinghouse Elect. Corp.* v. *United Elect. Radio & Mach. Workers of America*, 99 F. Supp. 597 (D. C. W. D. Pa. 1951); *John Hancock Mut. Life Ins. Co.* v. *Yarrow*, 95 F. Supp. 185 (D. C. E. D. Pa. 1951); 2 W. Barron & A. Holtzoff, Federal Practice and Procedure § 556 (Wright ed.); 3A J. Moore, Federal Practice ¶ 22.14[4]. But see *Pennsylvania Fire Ins. Co.* v. *American Airlines, Inc.*, 180 F. Supp. 239 (D. C. E. D. N. Y. 1960); *Liberty Nat. Life Ins. Co.* v. *Brown*, 119 F. Supp. 920 (D. C. M. D. Ala. 1954).

is no longer any procedural obstacle to the assertion of legal rights before juries, however the party may have acquired standing to assert those rights. Given the availability in a derivative action of both legal and equitable remedies, we think the Seventh Amendment preserves to the parties in a stockholder's suit the same right to a jury trial which historically belonged to the corporation and to those against whom the corporation pressed its legal claims.

In the instant case we have no doubt that the corporation's claim is, at least in part, a legal one. The relief sought is money damages. There are allegations in the compaint of a breach of fiduciary duty, but there are also allegations of ordinary breach of contract and gross negligence. The corporation, had it sued on its own behalf, would have been entitled to a jury's determination, at a minimum, of its damages against its broker under the brokerage contract and of its rights against its own directors because of their negligence. Under these circumstances it is unnecessary to decide whether the corporation's other claims are also properly triable to a jury. *Dairy Queen* v. *Wood*, 369 U. S. 469 (1962). The decision of the Court of Appeals is reversed.

It is so ordered.

SUPREME COURT OF THE UNITED STATES

No. 42.—October Term, 1969

Howard Ross and Bernard Ross, as Trustees for Lena Rosenbaum, Petitioners, v. Robert A. Bernhard et al. } On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[February 2, 1970]

Mr. Justice Stewart, with whom The Chief Justice and Mr. Justice Harlan join, dissenting.

In holding as it does that the plaintiff in a shareholder's derivative suit is constitutionally entitled to a jury trial, the Court today seems to rely upon some sort of ill-defined combination of the Seventh Amendment and the Federal Rules of Civil Procedure. Somehow the Amendment and the Rules magically interact to do what each separately was expressly intended not to do; namely, to enlarge the right to a jury trial in civil actions brought in the courts of the United States.

The Seventh Amendment, by its terms, does not extend, but merely *preserves* the right to a jury trial "in suits at common law." All agree that this means the reach of the Amendment is limited to those actions which were tried to the jury in 1791 when the Amendment was adopted.[1] Suits in equity, which were historically tried to the court, were therefore unaffected by it. Similarly, Rule 38 of the Federal Rules has no bearing on the right to a jury trial in suits in equity, for it simply preserves inviolate "the right of a trial by jury as declared by the

[1] Where a new cause of action is created by Congress, and nothing is said about how it is to be tried, the jury trial issue is determined by fitting the cause into its nearest historical analogy. *Luria* v. *United States*, 231 U. S. 9; see James, Right to a Jury Trial in Civil Actions, 72 Yale L. J. 655.

Seventh Amendment." Thus this Rule, like the Amendment itself, neither restricts nor enlarges the right to jury trial.[2] Indeed nothing in the Federal Rules can rightly be construed to enlarge the right of jury trial, for in the legislation authorizing the Rules, Congress expressly provided that they "shall neither abridge, enlarge nor modify the substantive rights of any litigant." 48 Stat. 1064. See 28 U. S. C. § 2072. I take this plain, simple, and straightforward language to mean that after the promulgation of the Federal Rules, as before, the constitutional right to a jury trial attaches only to suits at common law. So, apparently, has every federal court that has discussed the issue.[3] Since, as the Court concedes, a shareholder's derivative suit could be brought only in equity, it would seem to me to follow by the most elementary logic that in such suits there is no constitutional right to a trial by jury.[4] Today the Court tosses

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[2] See, *e. g.*, *Ettelson* v. *Metropolitan Life Ins. Co.*, 137 F. 2d 62, 65; 5 J. Moore, Federal Practice ¶ 38.07 [1] and cases cited therein.

[3] The principle that the Rules effected no enlargement or restriction of the right of jury trial has "received complete judicial approbation." 5 J. Moore, Federal Practice ¶ 38.07 [1] and cases cited therein.

[4] Virtually every state and federal court which has faced this issue has similarly reasoned to the same conclusion. See, *e. g.*, *Goetz* v. *Manufacturers' & Traders' Trust Co.*, 154 Misc., 733, 277 N. Y. Supp. 802; *Metcalf* v. *Shamel*, 166 Cal. App. 2d 789, 333 P. 2d 857; *Liken* v. *Shaffer*, 64 F. Supp. 432; *Miller* v. *Weiant*, 42 F. Supp. 760. The equitable nature of the derivative suit has been recognized in several decisions of this Court. See, *e. g.*, *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U. S. 541, 547–548. It was also reflected in the adoption of Equity Rule 94 in 1882, and Rule 27 of the Equity Rules of 1912 which established the preconditions to bringing shareholder's derivative suits in the federal courts. These rules are the forerunners of Rule 23 (b) of Fed. Rule Civ. Proc. of 1938, and of Fed. Rule Civ. Proc. 23.1 (1966), which now controls the initiation of such suits. See 3 J. Moore, Federal Practice ¶ 23.15 [1].

aside history, logic, and over 100 years of firm precedent to hold that the plaintiff in a shareholder's derivative suit does indeed have a constitutional right to a trial by jury. This holding has a questionable basis in policy [5] and no basis whatever in the Constitution.

The Court begins by assuming the "dual nature" of the shareholder's action. While the plaintiff's right to get into court at all is conceded to be equitable, once he is there the Court says his claim is to be viewed as though it were the claim of the corporation itself. If the corporation would have been entitled to a jury trial on such a claim, then it is said, so is the shareholder. This conceptualization is without any historical basis. For the fact is that a shareholder's suit was not originally viewed in this country, or in England, as a suit to enforce a *corporate* cause of action. Rather, the shareholder's suit was initially permitted only against the managers of the corporation—not third parties—and it was conceived of as an equitable action to enforce the right of a beneficiary against his trustee.[6] The shareholder was not, therefore, in court to enforce indirectly the corporate right of action, but to enforce directly his own equitable right of action against an unfaithful fiduciary. Later the rights of the shareholder were enlarged to encompass suits against third parties harming the corporation, but "the postu-

[5] See, *e. g.*, Frank, Courts on Trial 110–111 (1949). Certainly there is no consensus among commentators on the desirability of jury trials in civil actions generally. Particularly where the issues in the case are complex—as they are likely to be in a derivative suit—much can be said for allowing the court discretion to try the case itself. See discussion in 5 J. Moore, Federal Practice ¶38.02 [1].

[6] *Robinson* v. *Smith*, 3 Paige Ch. R. 222; *Attorney General* v. *Utica Ins. Co.*, 2 Johns Ch. R. 371, discussed in Prunty, The Shareholders' Derivative Suit: Notes on its Derivation, 32 N. Y. U. L. Rev. 980.

lated 'corporate cause of action' has never been thought to describe an actual historical class of suit which was recognized by courts of law." [7] Indeed the commentators, including those cited by the Court as postulating the analytic duality of the shareholder's derivative suit, recognize that historically the suit has in practice always been treated as a single cause tried exclusively in equity. They agree that there is therefore no constitutional right to a jury trial even where there might have been one had the corporation itself brought the suit.[8]

This has been not simply the "general" or "prevailing" view in the federal courts as the Court says, but the unanimous view with the single exception of the Ninth Circuit's 1963 decision in *De Pinto* v. *Provident Security Life Ins. Co.*, 323 F. 2d 826, a decision that has since been followed by no court until the present case.

The Court would have us discount all those decisions rendered before 1938, when the Federal Rules of Civil Procedure were adopted, because it says that before the promulgation of the Rules, "purely procedural impediments" somehow blocked the exercise of a constitutional right. In itself this would seem a rather shaky premise upon which to build an argument. But the Court's position is still further weakened by the fact that any "purely procedural impediments" to a jury trial in a derivative suit were eliminated not in 1938, but at least as early as 1912. For Rule 23 of the Equity Rules of that year provided that if a "matter ordinarily determinable at law" arose in an equity suit it should "be determined in that suit according to the principles applicable, without sending the case or question to the

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[7] Note, 74 Yale L. J. 725, 730.

[8] See, *e. g.*, N. Lattin, Corporations c. 8 § 3; 2 G. Hornstein, Corporation Law and Practice § 730; 13 W. Fletcher, Cyclopedia Corporation § 5931; 5 J. Moore, Federal Practice ¶ 38.38 [4].

law side of the court." 226 U. S. 654. These applicable principles included the right of jury trial.[9] Consequently, when the Court said in *United Copper Co.* v. *Amal Copper Co.*, 244 U. S. 261, 264, that "it is clear" that the remedy of a stockholder seeking to enforce the rights of a corporation—whatever their nature—is not in law but in equity, it was not because there were "procedural impediments" to a jury trial on any "legal issues." Rather it was because the suit itself was conceived of as a wholly equitable cause of action.

This was also true in *Fleitmann* v. *Welsbach Street Lighting Co.*, 240 U. S. 27, on which the Court so heavily relies even though it was a pre-Federal Rules case. In *Fleitmann* the plaintiff sued derivatively to enforce a corporate right of action for treble damages under the antitrust laws. Treble damages were considered punitive, and the statute was read to imply a right in the defendant to a jury trial. In his opinion for the Court, Mr. Justice Holmes recognized the potential for abuse: derivative rather than corporate actions could be brought in order to deprive the defendant of his right to a jury trial. The Court's solution was to dismiss the bill because the antitrust statute "should not be read as attempting to authorize liability to be enforced otherwise than through the verdict of a jury in a court of common law." I do not see how the Court today can draw sustenance from this decision. Rather, the *Fleitmann* case seems to me to stand for a proposition diametrically opposed to that which the Court seeks to establish; namely, for the proposition that because a derivative action is wholly equitable, there is no right to a jury trial. The Court in *Fleitmann* simply held that since there was a statutory right to a jury in all actions for treble damages under the antitrust laws, a derivative

[9] See *Southern R. Co.* v. *City of Greenwood*, 40 F. 2d 679.

suit seeking such damages could not be maintained. Thus the bill had to be dismissed.[10]

These pre-1938 cases, then, firmly establish the unitary, equitable basis of shareholders' derivative suits and in no way support the Court's holding here. But, the Court says, whatever the situation may have been before 1938, the Federal Rules of Civil Procedure of that year, at least as construed in our decisions more than 20 years later in *Beacon Theatres, Inc.* v. *Westover*, 359 U. S. 500, and *Dairy Queen, Inc.* v. *Wood*, 369 U. S. 469, in any event require the conclusion reached today. I can find nothing in either of these cases that leads to that conclusion.

In *Beacon* the plaintiff sought both an injunction preventing the defendant from instituting an antitrust action and a declaratory judgment that certain moving picture distribution contracts did not violate the antitrust laws. The defendant answered and counterclaimed for treble damages under the antitrust laws. He demanded a jury trial on the factual issues relating to his counterclaim. The district court held that even though there were factual issues common to both the complaint and the counterclaim, it would first hear the plaintiff's suit for equitable relief before submitting the counterclaim to a jury. The Court of Appeals affirmed, and this Court reversed, upon the ground that if the equitable claim were tried first, there might be an estoppel which would defeat the defendant's right to a full jury trial on all the factual issues raised in his counterclaim. Similarly in *Dairy Queen* the Court simply held that a plaintiff could not

[10] Moreover, since the suit was brought *after* the promulgation of Equity Rule 23 it seems evident that here, too, it was not merely "procedural impediments" that prevented the antitrust claim from being tried to a jury, but presumably the fact that no matter arising in a derivative suit—whatever its "inherent nature"—was considered to be one "ordinarily determinable at law."

avoid a jury trial by joining legal and equitable causes of action in one complaint.

It is true that in *Beacon* it was stated that the 1938 Rules did diminish the scope of federal equity jurisdiction in certain particulars. But the Court's effort to force the facts of this case into the mold of *Beacon* and *Dairy Queen* simply does not succeed. Those cases involved a combination of historically separable suits, one in law and one in equity. Their facts fit the pattern of cases where, before the Rules, the equity court would have disposed of the equitable claim and would then have either retained jurisdiction over the suit, despite the availability of adequate legal remedies, or enjoined a subsequent legal action between the same parties involving the same controversy.[11]

But the present case is not one involving traditionally equitable claims by one party, and traditionally legal claims by the other. Nor is it a suit in which the plaintiff is asserting a combination of legal and equitable claims. For, as we have seen, a derivative suit has always been conceived of as a single, unitary, equitable cause of action. It is for this reason, and not because of "procedural impediments," that the courts of equity did not transfer derivative suits to the law side. In short, the cause of action is wholly a creature of equity. And whatever else can be said of *Beacon* and *Dairy Queen*, they did not cast aside altogether the historic division between equity and law.

If history is to be so cavalierly dismissed, the derivative suit can, of course, be artificially broken down into separable elements. But so then can any traditionally equitable cause of action, and the logic of the Court's position would lead to the virtual elimination of all equity jurisdiction. An equitable suit for an injunction, for

[11] See discussion in 74 Yale L. J., at 736–737.

instance, often involves issues of fact which, if damages had been sought, would have been triable to a jury. Does this mean that in a suit asking only for injunctive relief these factual issues *must* be tried to the jury, with the judge left to decide only whether, given the jury's findings, an injunction is the appropriate remedy? Certainly the Federal Rules make it *possible* to try a suit for an injunction in that way, but even more certainly they were not intended to have any such effect. Yet the Court's approach, it seems, would require that if any "legal issue" procedurally *could* be tried to a jury, it constitutionally *must* be tried to a jury.

The fact is, of course, that there are, for the most part, no such things as inherently "legal issues" or inherently "equitable issues." There are only factual issues, and, "like chameleons [they] take their color from surrounding circumstances." [12] Thus the Court's "nature of the issue" approach is hardly meaningful.

As a final ground for its conclusion, the Court points to a supposed analogy to suits involving class actions. It says that before the Federal Rules such suits were considered equitable and not triable to a jury, but that since promulgation of the Rules the federal courts have found that "plaintiffs may obtain a jury trial on any legal issue they present." Of course the plaintiff *may* obtain such a trial even in a derivative suit. Nothing in the Constitution or the Rules precludes the judge from granting a jury trial as a matter of discretion.

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[12] James, *supra*, n. 1, at 692. As Professor Moore has put it, "Whether issues are legal or equitable may, of course, depend upon the manner in which they are presented . . . ." 5 J. Moore, Federal Practice ¶ 38.04 [1], n. 40. And he, along with virtually every other commentator, concludes that if the issues are presented in a shareholder's derivative suit they are equitable and the plaintiff has no constitutional right to have them tried by a jury. 5 J. Moore, Federal Practice ¶ 38.38 [4].

But even if the Court means that some federal courts have ruled that the class action plaintiff in some situations has a constitutional right to a jury trial, the analogy to derivative suits is wholly unpersuasive. For it is clear that the draftsmen of the Federal Rules intended that Rule 23 as it pertained to class actions should be applicable, like other rules governing joinder of claims and parties, "to all actions, whether formerly denominated legal or equitable." [13] This does not mean that a formerly equitable action is triable to a jury simply *because* it is brought on behalf of a class, but only that a historically legal cause of action can be tried to a jury *even if* it is brought as a class action. Since a derivative suit is historically wholly a creation of equity, the class action "analogy" is in truth no analogy at all.

The Court's decision today can perhaps be explained as a reflection of an unarticulated but apparently overpowering bias in favor of jury trials in civil actions. It certainly cannot be explained in terms of either the Federal Rules or the Constitution.

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[13] Original Committee Note of 1937 to Rule 23. Moreover, as Professor Moore points out, certain class actions could be maintained at law in the federal courts even before the Federal Rules. 5 J. Moore, Federal Practice ¶ 38.38 [2].